S. Hrg. 98-865

COMMODITY INVESTMENT FRAUD II

HEARINGS

BEFORE THE

PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

MARCH 19 AND 21, 1984

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COMMODITY INVESTMENT FRAUD II

MONDAY, MARCH 19, 1984

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 9:38 a.m., in room SD-342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. Warren B. Rudman (vice chairman) presiding.

Members of the subcommittee present: Senator Warren Rudman, Republican, State of New Hampshire, and Senator Lawton Chiles, Democrat, State of Florida.

Members of the professional staff present: S. Cass Weiland, chief counsel; James B. McMahon, deputy chief counsel; Chuck Morley, chief investigator; Katherine Bidden, chief clerk; Carol Fox, staff counsel; Michael Flynn and Vance Belcher, staff investigators; Sarah Presgrave, executive assistant to the chief counsel of the majority; John Sopko, assistant counsel to the minority; Dan Kalinger, press secretary; Carla Dooley and Cindy Comstock, staff assistants.

[Letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the Chairman, or any Member of the Subcommittee as designated by the Chairman, to conduct open and/or executive session hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Commodity Investment Fraud II, to be held on March 19 and 21, 1984.

WILLIAM V. ROTH, Jr.,
Chairman.

SAM NUNN,
Ranking Minority Member.

[Senator present at convening of hearing: Senator Rudman.]

OPENING STATEMENT OF SENATOR RUDMAN

Senator RUDMAN. The subcommittee will be in order.

This morning the Permanent Subcommittee on Investigations will once again look at a serious problem that has affected American investors for years, but particularly in the recent past—the problem of high-pressured telephone salesmen enticing people of all economic levels to invest in phony precious metals and other slick promotion schemes.

Senate Resolution 76 gives the subcommittee the authority to investigate all types of organized criminal activity, including commodity and security fraud schemes. Certainly, we have seen organized crime in this area, thus our interest in this subject is in the best traditions of this subcommittee.

In 1982, we held hearings which showed that Americans were losing at least $200 million per year in so-called commodity investment fraud schemes. Since then, we have seen several new schemes. It looks like our estimate of $200 million was too conservative. Americans may be losing five times that every year, if you take into account all the gold, silver, titanium, diamonds, oil and gas, and other deals the phony rooms are operating every day.

In 1982, Senator Roth and I tried to hand State securities administrators authority to use their securities antifraud jurisdiction against those even registered with the CFTC. We did not get all we wanted, but Congress did lift the Federal preemption somewhat and the Senate demanded CFTC cooperate with the States to a much greater extent.

I look forward to hearing from State and Federal authorities this week, since it is obvious that more troops have to be committed to this effort.

At this point, in the beginning of the hearing, we are going to play a tape recording made by an informant for a State enforcement agency. The matter is still under investigation, so the excerpts we play intentionally do not identify the name of the company or the salesman involved. But there is no need to identify these people. What you will hear is typical of the kind of thing that goes on hundreds of times every day across the country.

I will ask Mike Flynn, one of our investigators, to play the opening tape.

[At this point in the hearing, the tape recording was played.]

[The tape recording was marked "Exhibit No. 1," for reference, and follows:]

EXHIBIT No. 1

SUBJECT: CONVERSATIONS RECORDED BY GOVERNMENT DURING THE INVESTIGATION INTO A PRECIOUS METALS "BOILERROOM" OPERATION

PART I—A BOILERROOM SALESMAN TRIES TO PRESSURE A CUSTOMER (ED) TO BUY GOLD

SALESMAN. I've got to get this done. I've got a lot to do today. A lot of money to make for people today. Ed, Ed, we're giving you fifteen and one-half percent per annum. We'll give you, we'll give you the potential—profits are incredible—we anticipate big, big profits! But forget about the profits! If you hold on to your dollars you going to go down out the crapper! I'm offering you security, forget about the big money. (Pause) Is twenty-five thousand dollars too much for you? How about fifty thousand? Ed, let me tell you something. The dark cloud of this economy is passing over head, and it's going to rain on you if you don't get some shelter. It's going to rain on you if you don't get some shelter. You're conservative. You work all your life, it's so hard! Why are you fighting me? I'm not trying to take your big money here, I don't care how much you make here! I'm trying to give you shelter.

BACKGROUND VOICE. Now what are you going to do about it?

SALESMAN. Now what are you going to do about it Ed?

BACKGROUND VOICE. Let's get some action.

SALESMAN. What are you going to do about it? I want some action from you!

Background Voice. Close the guy.

Salesman. Some people talk—some people do.

Background Voice. Ask him his social security number. Put him down on paper. Whose name do you want this account in.

Salesman. Ed, you know what? In 1976, when gold was a hundred thirty dollars an ounce did you buy it? Well, I did. Why didn't you buy it? Well, I could have, I should have, and I would have, but I didn't. OK, Ed, we're not talking about Jack and the Beanstalk.

Background Voice. Get these new accounts up on the board, I want to see 'em. I wanna see 'em now.

Salesman. Ed, Ed, do you have serious intentions about protecting yourself here? Yes or no?

Background Voice. What name is the account going to read in? Get his social security number—get him down on paper.

Salesman. Alright, how do you want the account to read? What do you mean on hold? Nobody puts me on hold! Ed, we're controlling two hundred fifty ounce of long June gold at a big price of $450.90.

Background Voice. Write it down.

Salesman. Right. What are you waiting for? I already wrote this order up once, you want me to do it again? Cut it out! Alright, let's talk seriously now. You don't have $25,000.00. How much do you have? Alright then let's do this. We're gonna control one-hundred, not two-fifty, one hundred, get out your pen, one hundred ounces. Ed, be quiet for a second! Alright, we're going to do this. You have to do this to protect yourself. It's something you must do. Now get out your pen! Get out you pen. (Pause) Ed, what do you mean you're going to think this over seriously? I've already given you a week to think this over seriously. Now is the time, not to think, but to take action. Take a step here. You take the first step. (Pause) Ed, it was $409 last week now it's $417.90, just cut it out. Now we're talking about peanuts here. Are you that worried about the profits here? We're going to make money, but I don't care about how much money we're going to make here. I care about protecting your butt from what's going to happen. Let me tell you something, out in Warsaw, IL, you're going to be the last one to know about it. (Long Pause) Ed, are you telling you can't get your money out of the stock market today? (Pause) Alright Ed, you're saying that you can't get it done today? (Pause) Will you get it done tomorrow morning? I want a commitment from you. Huh? That's right okay, right now it's Friday, and obviously it's a good time to get in. Monday it usually goes up. Ed, I hear what you're saying. But you must not of heard what I've been saying the whole time. Your holding on to dollar bills, and it's just like you were holding on. (Pause) Ed, it's just what your holding on to gold when it was $800.00 an ounce coming down to $600.00 to $500.00 to $400.00 you're doing the same thing and everybody ignores the inviolability of the dollar. Except me. (Background noise unintelligible).

PART II—THE FRUSTRATED SALESMAN HAS HUNG UP ON THE CUSTOMER, THE MANAGER IS UPSET AND BEGINS TO COUNSEL ALL THE SALESMEN ON HOW TO TREAT THE "CLIENTS"

Manager. You have no right to hang up on anybody. No right to hang up on anybody without okay, thank you, please. You should say good bye. You took up, you took up a half hour of the man's time and you have the right to say good-bye to him. I never want to hear that, that's child, childish. Totally childish. When you get emotional and you let a client get you emotional to the point were you want to piss the client off that's childish, that that doesn't sell anything all that does is burn up leads burn up good people and possible someone else's sells. What? Nothing. Emotional will get you nowhere. Your've got to believe you own bullshit but be unemotional about it. Controlled hype is the name of the game. Controlled hype. Never get the guy pissed off at you. Don't get pissed off at yourself go on to the next one or go back to that guy and try a different approach. Think about what the guy told you. And sit down for about two minutes and analyze why you didn't close that guy. Maybe it's something you didn't hear that you didn't recall or maybe it's something you didn't say. Analyze why the guy's saying no. The guy says no to you because he's got his assets tied up in the stock market. I don't buy that. The guy is not sold on the program! He's got the money, the man's got thirty, forty, fifty. If he tells you he's got thirty grand in the stock market, he's got a hundred and fifty grand laying in a drawer somewhere. The main thing what you got to find out is that the guy is got the money! If the guy is got the money there is no reason why you can't get the sale. That's the only reason—the only thing you got to find out if the guy is a qualified buyer. A qualified buyer is a guy with money! If the guy comes out to you and says I don't have any money—good-bye. But if you got a guy that says I'm in the stock market or I'm here, you got a potential buyer! Be his friend, I'm here to help you. That's the way this man sells. He sells with charisma. And it works! Don't get pissed, take his money! Don't get emotional! Don't believe—believe your own bullshit, but don't get emotional about it! But when you're working on a guy that's 90% of your problem. He doesn't understand. He might have been with ten other companies, and he still doesn't understand how he lost his money. They don't understand it. They're afraid to buy it, but they don't know what they're buying. I mean do you understand the concept here—I have a man sending you $25,000.00 on a phone call? (Laughter in the background). I mean do you understand the concept here? Its awesome! Whoever he may be, whoever this outfit may be they'll mail every (obsenity) thing. You know why? Because he likes ya! And he trusts ya! That's the only reason he's sending you that money. Because he likes *you* better than the rest of the fifty guys who have been calling him. This is the guy, this is the guy who's going to get me in the market. I'm going to send him the money now. The money is waiting there to be sent. Any guy that speaks to you for five minutes is wasted and will send money to somebody. He's going to send money to somebody in the next couple weeks or a month. It's gonna happen.

Senator RUDMAN. So we fully understand that recording, the first part was a salesman trying to make a sale. After he hung up the telephone, the voice you heard was the manager of the operation lecturing him on what he did wrong. That, we believe from the information that we have, is typical of the kind of tactics that are used in these operations throughout the country.

We will start off our hearing this morning with our first panel: Chris Anderson, director of securities and Larry Fuchs, chief of investigations, office of comptroller, State of Florida; Dorene Wolf, senior council, department of corporations, State of California; Orestes Mihaly, assistant attorney general, investor protection and securities bureau, State of New York.

We would like to welcome the four of you. If you would please remain standing, I will administer the oath.

Do you swear the testimony you are about to give in the course of this hearing shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. ANDERSON. I do.

Mr. FUCHS. I do.

Ms. WOLF. I do.

Mr. MIHALY. I do.

Senator RUDMAN. We thank you very much for your cooperation and willingness to be of assistance to us. I believe we will start out with Chris Anderson. Perhaps if you have statements, and I believe some of you do, your entire statements will be placed in the hearing record when it is printed.[1] [2] [3] However, if you wish to summarize in any way, feel free to do so.

I did want to note that the ranking member, Senator Nunn of Georgia, very much wanted to be here this morning and has taken an active part in all our hearings. Unfortunately, he is in the State of Georgia this morning and is unable to be with us.

Please proceed.

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[1] See p. 107 for the prepared statement of E. C. (Chris) Anderson.
[2] See p. 116 for the prepared statement of Dorene B. Wolf.
[3] See p. 120 for the prepared statement of Orestes J. Mihaly.

TESTIMONY OF E. C. (CHRIS) ANDERSON, DIRECTOR OF DIVISION OF SECURITIES AND LARRY FUCHS, CHIEF OF INVESTIGATIONS, OFFICE OF COMPTROLLER, STATE OF FLORIDA; DORENE WOLF, SENIOR COUNSEL, DEPARTMENT OF CORPORATIONS, STATE OF CALIFORNIA; AND ORESTES MIHALY, ASSISTANT ATTORNEY GENERAL, INVESTOR PROTECTION AND SECURITIES BUREAU, STATE OF NEW YORK

Mr. ANDERSON. Thank you, Mr. Chairman. I am pleased to have the opportunity to appear before you as the representative of Florida's comptroller, Gerald Lewis, department of banking and finance. By way of introduction, I am the director of the securities division for the department. Larry Fuchs to my right is our chief investigator. I have been involved in securities investigations and the administration of Florida's Securities Act for 7 years, 3 of those years as an investigator and the remainder has been as an administrator and regulator.

Currently, I am the chairman of the Commodities Committee of the North American Securities Administrators Association and have recently been appointed to the Advisory Committee on CFTC/State Cooperation by the Commodity Futures Trading Commission. I am here primarily as a representative of my department, but I am also willing to answer general questions regarding NASAA's position relating to boilerroom activities.

The operation of boilerroom and precious metals investment fraud schemes is not limited to Florida alone. However, unfortunately, Florida has gained an unwanted reputation as the con man's capital of the world. Miami's Biscayne Boulevard is commonly referred to as "Maggot Mile." The number of boilerroom schemes cropping up in the Miami/Fort Lauderdale area on an almost daily basis is particularly alarming.

Florida has long had the glory of being known as a State where, like it or not, white-collar crime proliferates. The land frauds of the 1920's and 1960's and now the commodity and energy-related frauds have all seriously tainted the State's sunshine image. The national media has again focused on Florida's situation calling for corrective legislation.

In addition to this subcommittee's investigation, the Florida senate is also investigating precious metals frauds in the wake of the multimillion dollar collapse of International Gold Bullion Exchange and similar investment frauds.

Since October 1983, our department has filed actions against 77 different boilerroom companies. The majority of these have involved the sales in one fashion or another, of the Federal oil and gas lease lottery program through fraudulent means. In an effort to more quickly put them out of business, we have filed these actions as immediate final cease-and-desist orders, which have the effect of shutting down a firm's fraudulent offerings upon the filing of our action. Our department has found this administrative process to be much more efficient than attempting to obtain temporary restraining orders or preliminary injunctions when it is necessary to act very quickly in order to protect the investing public.

To say that boilerroom activity in Florida is a problem is an understatement. I have even seen television detective programs whose plots center around a fraudulent gold bullion operation. One certainly must agree that when Hollywood screen writers recognize boilerroom and precious metals activity as something worthy for television, it is an indication of a national problem to which anyone can relate.

An important point to note, that we have discovered in Florida, is that very seldom does a boilerroom solicit investors from the State in which they operate. The operators and principals of these companies clearly do this in order to avoid detection of their operation. Unfortunately, this method of operation often works and we become aware of their activity after it has closed shop and set up another boilerroom operation under a different name down the street.

Currently, our department is conducting investigations on approximately 70 different boilerrooms, approximately three-quarters of which involve the sale of off-exchange commodities and precious metals, particularly in the Miami and Fort Lauderdale area. In order to combat precious metals and boilerroom fraud, we have established a special task force within our department to handle nothing but these types of investigations. However, the problem is so vast and continues to proliferate at such a rate that any agency interested, whether they be State or Federal, would have its hands full just trying to investigate the worst ones. Consequently, we have recently planned meetings with any interested State or Federal agencies in order to literally cut up the pie and establish investigative boundaries.

We feel that by dividing up different investigations any agency will then be able to more easily concentrate on a particular company, its principals or their activities. Regardless of who does what and when from an enforcement standpoint, what is important is that something be done to put a stop to this sort of fraudulent activity.

What we have also done in Florida to combat boilerroom operators, promoters and salesmen is to introduce legislation which will essentially prohibit boilerroom sales activities in Florida. Should this legislation pass, it will probably become effective some time in June or July of this year. We are most anxious to rid Florida of fraudulent boilerroom activities.

At this point, I would like to turn to Mr. Fuchs who has some charts here we think you all might be interested in.

Senator RUDMAN. Thank you very much. Mr. Fuchs, would you like to proceed?

Mr. FUCHS. Yes, sir. We have prepared charts which are basically intended to show the proliferation of boilerroom activity in Florida. They show two principal groups engaged in precious metals activity and only those two groups. We have identified other groups, but it would just be too unwieldy to put everything on a chart basis. We have also limited the charts to public record. What you see is information available primarily through the secretary of state's office, corporate registrations, and we have left off most of what is normally known as investigative or intelligence information.

Also, there are copies of these charts attached to the Florida statements.

On the chart to the left, we have 13 principals and brokers of Universal Precious Metals, Inc. These individuals, after Universal Precious Metals was closed down, have spread into a minimum of 40 different companies. These are not all the companies these individuals have organized. We have tried to exhibit a representative sample. There are many interrelationships shown graphically here, and if you will permit me, I will step over there.

Senator Rudman. Go right ahead. Also, the charts will be made a part of the record.

[The charts referred to were marked "Exhibit No. 2," for reference, and follow:]

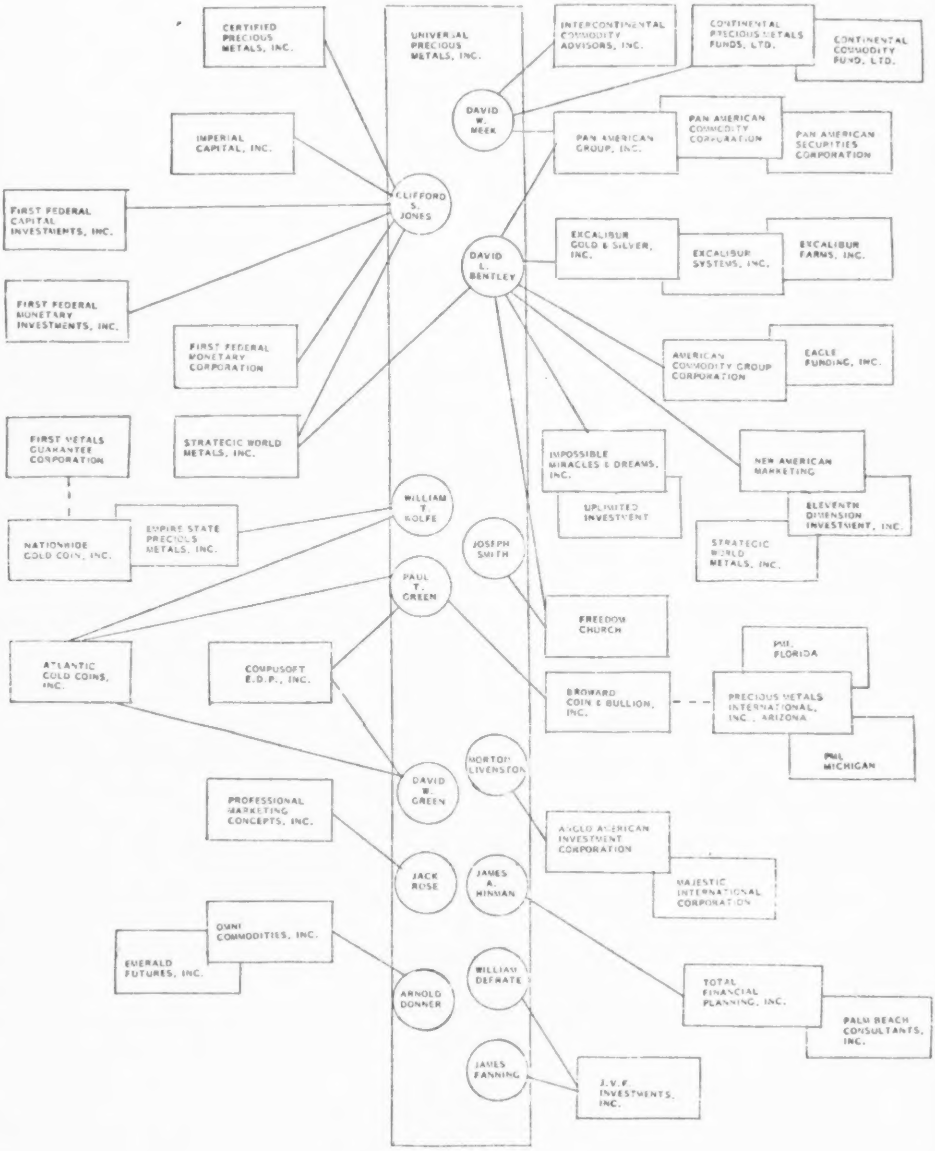
EXHIBIT NO. 2

1984

STATE OF FLORIDA

OFFICE OF COMPTROLLER

COMMODITY RELATED INVESTIGATIONS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IMPERIAL CAPITAL, INC.
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EMPIRE STATE PRECIOUS METALS, INC.
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COMPUSOFT E.D.P., INC.
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1984

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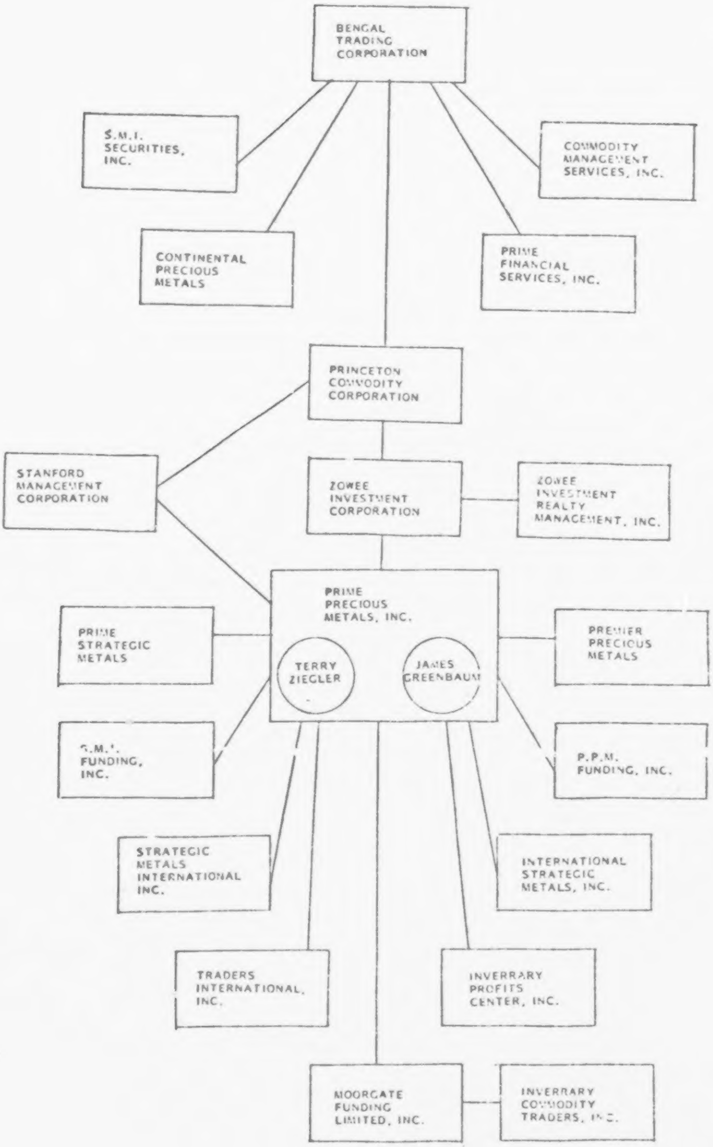
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INVERRARY COMMODITY TRADERS, INC.

3/12/84 - L. H. FUCHS, CHIEF OF INVESTIGATIONS

Mr. Fuchs. For example, we have David Bentley and a group of about 12 companies associated with him. Mr. Bentley used to have the last name of Smith and is believed to be the brother of Joseph Smith. The two of them have been involved in the Freedom Church of Revelation under investigation in the Connecticut area.

Mr. Smith, after or at the same time his church operation was under investigation, was also believed to be working for Imperial Capital Co. Imperial Capital was partially set up and partially operated by Clifford Jones, the individual that Mr. Bentley bought Universal Precious Metals from.

Mr. Jones left Imperial Capital and we believe he is now involved in a company called London Metals. London Metals was organized or operated by Morton Livenston down here and is connected on the other chart to Moorgate Funding, which I will get back to, down at the bottom.

Mr. Meek, responsible for at least six companies depicted here in this group with the beginning name of Pan American, also operated a company called Pan American Oil & Gas. They were an oil and gas BLM lease lottery program that we took action against in October of last year. They are not on the chart but it shows the interrelationship between precious metals dealers and the oil and gas people.

Down under Broward Coin & Bullion, one of the organizers is Paul T. Green. This company has as one of its officers an officer of Precious Metals International in Arizona. Precious Metals International also has Florida operations and Michigan operations. In the Florida operation, the manager is one Steve Sawyer. Mr. Sawyer is one of those under indictment for Stanford Management Corp. over on the other chart.

In this group, there is a company in Florida called First Metals Guaranty Corp. The telephone for that company is now answered "Nationwide Gold Coin." Nationwide Gold Coin was organized by approximately six or seven of the individuals who were previously associated with Empire State Precious Metals which closed after the New York attorney general's office took action on them in New York. They simply moved to Florida, moved in with another company, changed the way they answer the telephone, and continued in business.

The second chart is basically a new version of what this subcommittee generated in 1982, the Commodity Club. Many of the companies from almost the bottom up have been previously depicted, but we find that the same principals are now involved in a company called Moorgate Funding Ltd., Inc. Moorgate Funding has been advertising for salespeople. Some of the interviews for the salesmen for Moorgate Funding have been conducted by Mr. Livenston of London Metals and these previous companies, by a gentleman associated with Inverrary Commodities Traders, Inc., and by an individual associated with Total Financial Planning.

So there is a definite correlation, at least between these two groups and, as I say, there are others.

If you would allow me to cover one specific story that is current right now? Mr. Jones, as I said, sold his interest in Universal Precious Metals to Mr. Bentley. He then helped form and became the regional sales manager for Imperial Capital, Inc. In August 1983, just a few months ago, apparently there was some dispute. Mr. Jones left Imperial Capital, taking with him some of the personnel. They set up First Federal Monetary Corp. and First Federal Monetary Investments, Inc. In November 1983, they set up First Federal Capital Investments, Inc., and the paperwork sent to customers from the first two companies began to have the First Federal Capital letterhead on it.

In December 1983, they began to tell the customers that they had changed the names of the companies. We then learned these individuals were selling contracts that were due in February 1984. On February 15, this is approximately a month ago, we served—excuse me, on February 23, we served a subpena on First Federal Monetary Corp. demanding their books and records. We were detained at their place of business for an extended period of time, and finally, upon insistence, were allowed to talk to an attorney that represented them, one Joseph Cillo. Mr. Cillo was also one of the directors of Imperial Capital. Mr. Cillo promised compliance on the following Tuesday, a few days later. The compliance didn't occur. We returned to the company, and we were then told that Mr. Cillo no longer represented them, a Mr. Halfhill of the firm of Field & Halfhill in Virginia represented them.

We negotiated with Mr. Halfhill for several days and found that on the following Saturday, some 3 days later, First Federal Monetary simply moved out, boxed everything up and abandoned the offices.

We continued to try and negotiate with Mr. Halfhill and he referred us to his partner, Mr. Jack Field. On the 6th, several days ago, Mr. Field said he no longer represents the company, and they are no longer there, and we will have to pursue this in circuit court in Florida.

I would like to go a little bit beyond the charts and show some other relationships that have become obvious. Perhaps I can return to the microphone. That will help the media.

On the smaller chart, starting in the upper right, the following companies all have the same attorney as resident agent. That attorney is Mr. Arthur J. Green. Commodity Management Services, Inc.; Prime Financial Services, Inc.; Zowee Investment Corp.; Zowee Investment Realty Management, Inc.; SMI Funding, Inc.; PPM Funding, Inc.; International Strategic Metals, Inc.; and Inverrary Profit Center, Inc.

There are other relationships that show up. For instance the address of 5950 West Oakland Park Boulevard—Continental Precious Metals; Prime Financial Services; Zowee Investment; Zowee Investment Realty; Prime Precious Metals; SMI Funding; Strategic Metals International; PPM Funding; Inverrary Profit Center; and a new company not depicted, Investment Prospects, Inc., are all of that same address.

And, finally, another individual who appears at that address in a different suite is Attorney David R. Mackenzie. Mr. Mackenzie was the secretary of Continental Precious Metals, again, on the right-hand chart. He is the resident agent of Moorgate Funding, of Inverrary Commodity Traders and, again, of Investment Prospects, Inc.

And then back to the other chart, Mr. Mackenzie also represents William T. Wolfe and is secretary of Empire State Precious Metals, the company the New York Attorney General's Office took action against. He is the resident agent of Compusoft and of Atlantic Gold Coins. He is the resident agent of Professional Marketing Concepts and represents Jack Rose. He has represented JVF Investments, Inc., at the bottom of the chart, and has represented the Freedom Church of Revelation in New York. He has interviewed the sales people of Universal Precious Metals on behalf of David Bentley and has formed an offshore corporation for Mr. Bentley's benefit, which I believe the chairman may address.

He has also formed an offshore corporation for the benefit of Jack Rose. So we have an individual there who bridges both of these areas and may, in fact, have involvement beyond what I have just described.

Finally, Mr. Chairman, from an enforcement standpoint, as Mr. Anderson mentioned, we have taken action against 77 companies since October just passed. Four of those companies are in the precious metals area, three of them are pending action at this time, one declared bankruptcy the day after we took our action. We believe that because of the effectiveness of what we have done in the oil and gas area, we may push these people into the precious metals segment. They have to earn their living somewhere and they probably will not abandon their way of life.

We have organized, next week, a meeting to take place in Florida which will be attended by the CFTC, the FTC, the SEC, main Justice, and a number of enforcement authorities within the State of Florida. We hope at that time to address how we can effectively begin enforcement of this myriad of companies in the precious metals area. Thank you.

Senator RUDMAN. We appreciate that testimony. I have just one question at this point, and then we will go on. How many of these companies had registered with CFTC?

Mr. FUCHS. I don't have an exact figure, sir. There are a number of them on the righthand chart and a minimum on the left.

Senator RUDMAN. Of course, for those that are—if you want to consult for a moment——

Mr. ANDERSON [interposing]. I was going to add I believe Imperial Capital Corp. on the lefthand chart is registered with the CFTC in one capacity or another. I believe it is a commodity pool operator or FCM, I am not sure which. The majority on the lefthand chart, I don't believe are registered with the CFTC.

Senator RUDMAN. Of course, to the extent they are, then you have real problems other than using your own Florida fraud laws. You have real difficulty using your securities laws, which is what we held discussions about last year. That is still a problem?

Mr. ANDERSON. Yes, sir; it is.

Mr. FUCHS. It was the CFTC actions that closed Universal Precious Metals, the center of this chart, and led to the diversification, if you will, of these individuals.

Senator RUDMAN. Just a further question, and then we will go on to our witness from California and our witness from New York. In the State of Florida, if someone wants to set up a business calling it London Precious Metals, for example, what State legal requirements are there for that company to go into business in the State of Florida?

Mr. **Anderson**. Well, I would imagine—let's say they are very minimal, to say the least. Obviously, the State does not regulate them, per se. They have no one to register with. Perhaps local licensing requirements, you file a fictitious name notice in the newspaper in the legal advertising and, boom, they are in business. It is that simple.

The problem is such that even if we required registration of people about to perpetrate frauds, I would think they wouldn't advise the State they are going to do that. There is nothing for them to do except get a bank of telephones, that is, a WATS line, and some slick people to sell their program, and they are in business.

Senator **Rudman**. As a matter of fact, even to the extent you have a trade name doing business as law in the State, they feel free to disregard that, of course. That might be some sort of an alert to the State or Federal officials, I assume.

Mr. **Fuchs**. We have, in the oil and gas area particularly, found some blatant violations of trade names. We had du Pont Oil Co., and Rockwell International Oil & Gas, and we had several companies that are obviously attempting to infringe on the good name of regular corporate entities in the United States.

Mr. **Anderson**. That is typical. In noting any of the names of the companies on the charts, even as I recall from the Commodity Club charts in your hearings 2 years ago, Princeton Commodities—any number of firms that seem to, let's say, use a name that the general public can more readily identify with, from a credibility standpoint. That is exactly what they are trying to do and obviously they are successful.

Senator **Rudman**. I am going to come back for some other questions, but we are going to move on now to Dorene Wolf, senior counsel, Department of Corporations, State of California.

Ms. **Wolf**. Thank you, Mr. Chairman.

Senator **Rudman**. If you could pull the mike a bit closer, you will be a little easier to hear.

Ms. **Wolf**. I want to thank the subcommittee for inviting California here to give evidence and to assist this subcommittee in some way in cleaning up the mess that is just beginning in California. It wasn't until late 1983 that the department of corporations was informed about precious metals fraud in California. One of the reasons I believe we are latecomers in this area is because we have just started up, I believe—the investors have long-term contracts and, therefore, have not come forward.

Another reason is I believe investors in these commodities frauds are solicited from other States from the State of California and rarely nowhere to go.

Most of these contracts, as I say, run from 18 to 25 months and the investor during the interim receives computer printouts showing profits. Then he is high-pressured into turning those profits into other commodities and investments and he doesn't realize he has been defrauded until the price of gold goes up and he tries to liquidate his accounts and finds there is no one there to answer his telephone and is consistently faced with busy signals.

The preliminary information given to the department of corporations at this time is that the investors really believe they are getting gold. Now the department of corporations has not gone public with any actions yet; therefore, any testimony I may give cannot be directed to any single company, nor can I identify any of the participants.

My preliminary information shows that some companies admit to $10 million gross income a month from these securities frauds.

Senator RUDMAN. You are talking $10 million of gross sales per month?

Ms. WOLF. Yes, Senator.

Senator RUDMAN. Some of these dealers in California are doing that kind of business? If those figures are accurate, we are talking about only one dealer doing in excess of $100 million a year, just in the State of California.

Ms. WOLF. That is correct, Senator.

Senator RUDMAN. I would suspect estimates we had earlier were low.

Ms. WOLF. The unfortunate part about this is there are 20 to 25 dealers identifiable now in the Newport Beach area. What really frightens me is our friends from Florida seem to have driven out 70 houses there and I do fear they may be coming to California as they open and close and reopen at will.

Senator RUDMAN. Both States have similar climates.

Ms. WOLF. Yes, it is very hard to get a salesman to work——

Senator RUDMAN. We haven't had too many in New Hampshire. It is a little cold up there. Go ahead.

Ms. WOLF. Our preliminary investigations have shown just as Florida has borne out that many of these firms are engaged in concerted efforts, that many of these houses meet, discuss how to get more money from investors and discuss the high-pressure tactics that should be used.

I have served somewhere between 18 and 25 subpena duces tecum and had the pleasure of having five of these houses close down after the service of the subpena. I don't think that my luck will hold out quite this way. One of the problems with enforcement in California is that with grand jury subpena power, which is what the State of California Department of Corporations has with its subpena, there is no contempt power for disobeying the subpena. What I must do then is go into the State court and file an action for a compliance. If I am lucky and I win, and I may have to show the relevance to securities violations, the court automatically gives another 20 days to the defendant to produce. That sometimes puts me at a 40-day disadvantage and time for the house to clear out.

I have had compliance where the people come forward with a box of records only to find that they sack up everything else in plastic garbage bags and move out. One company moved out of the jurisdiction of the United States into Canada where we were able to invite the Canadian authorities to assist us in apprehending these people.

My information is that they have had trouble with the Canadian authorities. I realize now there are many companies who were going to Canada who may not go now. That will make little difference to investors because it matters not where these houses establish themselves. They will always have a WATTS line and will always be able to reach U.S. investors.

I don't believe that civil remedies is the answer. I really believe that what we are looking at is a call for hard time, criminal action. There is no other way. They laugh at our subpenas; they laugh at our restraining orders. Nothing stops them except the possibility of criminial indictments, and I mean criminal indictments not only for the principals, Senator, but the sales people who make these operations viable.

The State of California has joined its forces in a multistate task force through the auspices of NASAA. We believe that this is one way of getting cooperation from States for those States which do not have the resources to pursue this kind of massive fraud.

The State of California Department of Corporations is prepared to mobilize its entire enforcement efforts in combating this problem. At the present, we have committed one lead counsel, which is myself, one backup counsel, and one investigator. We have 13 State laws to administer and enforce. At present, we have 20 lawyers throughout the entire State of California, 20 investigators and 687 open enforcement cases under the various 13 laws.

As you can see, we are stretched rather thinly. It is my understanding that the CFTC has but to show there is a sale by an off-exchange house and they have the power to move. But the CFTC is also stretched very thinly, Senator. They have two experienced lawyers in the entire western region, that is 11 States; one secretary, no investigator, and two inexperienced lawyers. I do recommend there be some kind of funding either on a special task force for them or permanently to combat these violations not only in the precious metals area but in all commodities fraud.

I have one second request that this subcommittee should be aware of; that is the sharing of information with other Federal Governmental agencies. I have no quarrel with the statute as it reads now under the Commodities Exchange Act. However, when trying to share information with the SEC, we find that their laws on discovery and sharing of information conflict with ours.

The State of California allows information to be disseminated to other agencies, such as the district attorney's office and other criminal agencies, the Attorney General or the U.S. attorney's office. However, when we have a chance to share information received from the SEC, we are precluded by their law which says that we cannot make use of any information received from the SEC unless they give us permission. By the time we get permission, the permission is usually too late. That is another area in which we would like to have greater legislation.

Because California is so new in the commodities area, I have nothing more to add to my statement, unless you have questions, Mr. Chairman, I will be happy to entertain them.

Senator RUDMAN. Thank you. I am going to ask one brief question. I am familiar with the very excellent statewide law enforcement capabilities in California. You have some district attorney's offices which are larger than the entire Attorney General's office in my State and a lot of investigators, people who are good at investigating all kinds of white-collar crime. I am curious—in some of the locations in your State where these matters might have come to the attention of a local district attorney, have there been any efforts to prosecute under your appropriate civil or criminal fraud statutes?

Ms. **Wolf**. I am reluctant to answer for the district attorney's office, Senator. However, California has just begun investigating commodities violations. The procedure usually is to obtain probable cause for some crime or theft, unless there is an obvious securities violation which, incidentally, is very difficult to prove—it is a highly technical and factual violation—the district attorney's offices often let us do our own investigation for the securities violations which we then share with them and aid them in participating in some kind of criminal prosecution.

I believe at this point, California is so new in this that it is rather premature to say whether or not the district attorney's offices are being as diligent or vigilant as we would like.

Senator **Rudman**. The reason I ask the question, and I really address this to all of the witnesses that will be before the panel, is that local prosecutors tend to want to deal with traditional crime. I say that not critically, having worked in law enforcement for a long time myself; that is to be anticipated. You give a local prosecutor a kidnapping case, a homicide case, a case of robbery or burglary, or a case of fraud in a local business and, generally speaking, they handle it rather well.

It seems to me that one of the problems we all face in this, because of jurisdictional problems, is the fact that when you get into the area of securities, it scares a lot of people away. It tends to look very complex.

In my view, many of the kinds of things that have come across this subcommittee's desk in the last 3 years could be handled by civil fraud and, in many cases, criminal statutes which are already part of the codes of most of the jurisdictions. It is an education process. I don't know who is responsible for that education.

If you were to look at the relatively small number of people who are in your offices that are in the CFTC, to the extent that local prosecutors could act, I think it would help. There were problems there also, jurisdictional problems, and so forth. We had a witness before this subcommittee a month or so ago, a sheriff from Indiana who we brought before this subcommittee to testify as to what he had done on a very complex hazardous waste problem in his county. One normally would have thought that it would have been up to the State EPA. However, he took the lead in the case and, as a result, he is educating many of the sheriffs in the Midwest on the fact that many so-called traditional crimes are not nearly as serious to his community as nontraditional crimes, like a hazardous waste dumping site. He also helps put together task forces to work together on these problems. I think we are going to have to do the same thing here. I look at the charts from Florida, and I hate to tell you this, but from our experience, you are going to have a chart like that. My friend Orestes Mihaly probably already has a chart that makes that look small. It seems to me that we are going to have to bring a lot more of this country's law enforcement capability to bear on this problem, being mindful of some of the jurisdictional problems that we have.

With that, unless you want to comment on that at all——

Ms. WOLF [interposing]. The only thing I can say, Senator, is that apparently local government sees violent crime and bodily injury as more important crimes than just mere money crimes. However, let me add that I have been prosecuting business crimes now for 4 years, which is a very short time, and I have seen people who have committed suicide and lost their minds, which is the same as bodily injury.

Mr. MIHALY. I agree with that, Senator.

Senator RUDMAN. I want to welcome Orestes Mihaly here, assistant attorney general, Investor Protection and Securities Bureau, State of New York, representing the attorney general, State of New York, Mr. Robert Abrams, who was helpful to the subcommittee and took part in our initial press conference. Mr. Mihaly has also been very helpful to the subcommittee. Mr. Mihaly, we welcome you. You have an excellent statement for the record. To the extent you can summarize it, go right ahead.

Mr. MIHALY. Senator, I want to express, again, my thanks for being invited to come down here today to participate in this very serious study by your subcommittee. We salute the continuing interest of this subcommittee into the problems of the American investor.

As you said, I have a very extensive statement, and I will try to summarize that as much as I can in 10 minutes.

I am here today with two of my colleagues, Mark Tepper on my left here who was lead counsel in the *Mineral Resources* case prosecuted in New York. Seated behind me is Ronald Eisenman, who is lead counsel in the Bullion Reserve of North America case, BRNA.

I appeared here, Senator, as you may recall, 2 years ago on the CFTC hearings on reauthorization. I alluded then to the fact that boilerrooms proliferate like Hydra. I recall vaguely reading about Hydra in my mythology classes in high school. The *Mineral Resources* case was an answer to the Hydra syndrome, I think. I think we demonstrated that in New York. The *Mineral Resources* case involved the sale of strategic metals in New York by a boilerroom. First of all, we determined that the criminal prosecution was absolutely essential in the elimination of boilerrooms in general. Boilerroom operators pay no heed whatsoever, I think, to civil injunctions or civil orders, especially when they have hundreds of thousands of dollars secreted away in the Cayman Islands or some other offshore depository. Criminal action is what we thought was necessary and what was really necessary was to indict and prosecute all the people connected with the boilerroom, including the salesmen who have virtually gotten away without any criminal prosecution. The *Mineral Resources* case started some time in February 1982 when I was testifying here in the latter part of February 1982.

That case, including the pretrial evidentiary hearings and the picking of the jury and the trial itself and the deliberations of the jury, which took 2 weeks, lasted over 6 months. The State of New York expended hundreds of thousands of dollars in man-hours to prosecute this case. I think we proved by this case, by the dramatic chilling effect it had in New York of reducing the activities of boilerrooms, that the "Hydra" syndrome can only be eliminated by criminal prosecution and prosecuting as many people connected with the boilerroom as possible.

Of course, we were met with arguments that the boilerrooms that we prosecuted during the 1981–82 era were not securities and not commodities, not subject to the regulation of any regulator. These are the so-called regulatory cracks that have developed and trouble still, I think, exists with respect to the preemption problems with the Commodities Exchange Act. However, even though we were able to eliminate the activities of the boilerrooms operating out of New York, I am not saying there aren't any, of course, there are, but there are significantly less, we came upon the new scams that were being perpetrated in a nationwide manner. The scams I have reference to are the gold bullion, silver and precious metals vendors, such as IGBE of Florida and BRNA of California, and my statement goes into details as to our connections with those cases.

Suffice it to say we have indicted, we were first to indict the principals of IGBE in Florida in Westchester County in New York. Our office is unique in that it has both civil and criminal jurisdiction. We do not have to refer our cases to a district attorney or like the SEC or CFTC to Federal prosecutors. We can either go civilly or criminally ourselves. We have this unique and powerful advantage in combating these frauds.

Nevertheless, we were faced with these huge scams which dwarfed the operations of the boilerrooms that we had been dealing with with respect to strategic metals.

Senator RUDMAN. When you talk about huge, since some people are unfamiliar——

Mr. MIHALY [interposing]. Between IGBE and BRNA far in excess of $100 million was lost by the public nationally. Within the last 2, 3, 4 weeks, one other company I know of, J. David in California, went into bankruptcy leaving losses allegedly of $125 million.

As you say, Senator, these figures are just adding up astronomically. We are dealing with a very large problem. In New York, we had the philosophy of not waiting for complaints in the *Mineral Resources* case. We tried to assume an aggressive, affirmative attitude by infiltrating the boilerrooms before victims even knew they were victimized.

As I say, we came upon this new form of scam, which is somewhat different from other boilerroom operations because it did not rely on the traditional cold call that the boilerrooms are so well known for. Thus, we saw tremendously large and repetitive advertisements in the New York newspapers, very respectable newspapers like the New York Times and the Wall Street Journal. We saw slick brochures printed and distributed by these firms.

Senator, I am sad to say it looks so legitimate, based on the magnitude of the ads and repetitious nature of these ads, prime network TV ads, during the "Winds of War," radio spot bits on all news radio stations in New York. Everybody had the opinion, I suppose you couldn't blame the public for feeling, "Well, this must be a legitimate operation. Somebody up there in Government must be looking at it." Unfortunately, no one was. We maintain that it is a national problem. We maintain that the Federal regulatory agencies missed the boat for one reason or another, probably because of lack of resources.

All that came out of our investigations and as the investigations by the trustees in bankrupty have discovered, are two gigantic, colossal, brazen Ponzi schemes, using money of subsequent investors to keep the earlier investors happy. The tragedy of the situation, I think, is emphasized in that the Federal regulators should have either been more assertive in asserting their jurisdiction; if they had not been successful in asserting their jursidiction, so be it, but at least they should have tried.

If someone had been on top of this situation, we feel tens of millions of investors' money throughout this country would have been saved. Hundreds of poignant stories of trauma—the trauma that results from white-collar crime is incredible, suicides, thoughts of suicides, depression, heart attacks, strokes. This is a very important and serious situation. White-collar crime can have as much impact as a violent crime.

Anyhow, the real tragedy is that no one really tried. And another tragedy that our investigation has disclosed—two very respectable—and I don't know what the answer is to this, Senator—two very respectable accounting firms were called in to audit the books of BRNA more than 1 year, 2 years before the bubble burst, and they reported back to the corporate officers that they had found significant shortages, significant losses by the public. No one came forward to any regulator. No one exposed the owner of this company, Allan Saxon, as a fraud and a cheat. The moneys came in at an even greater rate of receipt and millions and millions of dollars continued to come in.

What is the answer to all this, Senator? I know it is very easy to point out what the problems are and who didn't do what and who should have done what, but the answers are what are important. The answers are important to the American public. We in New York have taken a very serious look at these problems over the last several years. As I say, we have tried to approach this problem in an affirmative way. We have proposed, at the present time, three proposals as far as legislation is concerned. One that will eliminate or make illegal, make it a felony to engage in what we call a prohibited sales practice—that is, to conduct a boilerroom operation by cold canvassing when you are not registered with the SEC or CFTC.

We have a bill requiring commodity registration for anyone selling in New York or into New York who is not registered with the SEC, CFTC, or any self-regulatory agency, and we have a specific bill aimed at the gold bullion, silver bullion problem which will require that the gold bullion or silver vendors make immediate delivery of their merchandise or segregate the funds unless they have significant financial assets——

Senator RUDMAN [interposing]. Let me interrupt at this point, Mr. Mihaly. These laws are currently pending before the New York State legislators?

Mr. MIHALY. The first two are, and the last one I referred to is presently being finalized for introduction in the next week or so.

Senator RUDMAN. Is there an estimate as to the likelihood of their passage in New York?

Mr. MIHALY. I don't want to second guess the New York Legislature. I sincerely hope they will pass one or more of these statutes. Even if they don't, I hope these statutes may become models for other States to follow or for the Congress itself, in deference to this subcommittee—possibly the third bill, the one dealing with closing the regulatory gap with respect to gold and silver precious metals.

Senator RUDMAN. Is there considerable opposition to these bills?

Mr. MIHALY. I think we have tried to get the help of the bar associations in New York and the legitimate industry in New York, and other States. We have the right not only to protect our citizens from fraud, but we also have the duty to clean out our own backyards of these people who prey on people all over the country. The New York investment industry is very essential to our local economy, and we have, hopefully, the support of the local industry, the legitimate businessman in New York and the bar associations in these bills.

Senator RUDMAN. The problem historically with any of these bills has been that the ligitimate securities industry, which comprises 99.8 percent, of the total industry, gets concerned that the net is cast too wide, and then they are going to have problems. That is a legitimate concern.

Mr. MIHALY. Absolutely, that is a legitimate concern, but I think we have drafted our statutes so that they really have no concern because they will be all registered with the CFTC or SEC. So that the legitimate businessman is not the object.

The object of our statutes is directly the boilerrooms who are not registered. Of course, we hear about them——

Senator RUDMAN [interposing]. Of course, even if you pass those three laws in the State of New York, then, of course, we have the problem of the other 49 jurisdictions and what their laws are. The phones do go across State lines, irrespective of your law. That is another problem, which is why, of course, we are having these hearings, because it is a national problem.

Mr. MIHALY. In addition to the legislation I mentioned, I think we should urge all regulators and prosecutors to be a little more aggressive, to not be as timid, assert their jurisdiction even if they lose a case. We were faced with motions in the *Mineral Resource* case stating we were not dealing with a security. We were willing to take the chance that we would be shot down by the courts or by the jury, and luckily or hopefully we were successful in our operation there.

I think there should be more resources in general for white-collar crime prosecutors. There is always a feeling amongst the legislators and the budget people that white-collar crime is something less important than violent crime. I don't want to compare white-collar crime with murder and rape and pillage, but there is an awful lot of trauma that is caused by white-collar crime by these operators.

Senator RUDMAN. Of course, Mr. Mihaly, the fact of the matter is that it is not only the prosecutors and legislatures, it is the judiciary in many cases. If you look at our record of sentencing in white-collar crime, not just in this area, a lot of areas, you find there are greatly different standards applied. I agree with you, because I know personally of cases, of substantial individual losses. I am sure you all have cases similar to the case I will cite here briefly, you all have similar cases of a lady who was severely disabled, who was left some money for that disability. I think it was about $150,000, and in the space of an 8- or 9-month period, those funds were gone through one of these gold bullion deals, causing just enormous personal tragedy. We all know stories like that.

Mr. MIHALY. Absolutely.

Senator RUDMAN. I happen to think that the standard of sentencing for people who perpetrate those crimes ought to be the same as those who perpetrate a violent crime. It is a different kind of violence, but it is just as damaging and, in some cases, more permanently damaging than the other kinds of crimes.

Mr. MIHALY. Absolutely. I couldn't agree with you more, Senator. In addition to the judiciary, we have the correctional system. In New York, for instance, we have difficulty because our jails are insufficient to keep as many people in there that need to be put in there. We see that the white-collar criminals are released very early, if they do get a prison sentence. The amount of time they actually spend in prison makes a mockery of their prosecution.

I would like to also add to my friends in the CFTC, they have a tremendous hurdle to overcome. They have a staff, as I understand, of 100 people in the enforcement area to cover all the nationwide scams that are going on, as well as to regulate the legitimate commodities industry. To have 100 people in the Enforcement Division, including lawyers, investigators, clerks, and stenographers of the courts, librarians, what have you, is absolutely ludicrous. The con men know what is going on. They know the CFTC cannot handle it. Deregulation may be all right, but it should not be at the cost of millions of dollars lost by the investing public.

One last thing, Senator. White-collar crime, I think, in general, is sort of a preventable crime. You can't really educate against murder or robbery, but you can educate against certain white-collar crimes, especially boilerroom crimes. We have to, and I hope this subcommittee not only comes up with an answer or suggestions or recommendations with respect to legislation, closing the regulatory gaps, or suggesting different priorities for the regulators, but also I hope that this subcommittee comes up with a serious and well-conceived method of educating the American public to bring their level of awareness up, to prevent—an ounce of prevention is worth a pound of cure.

I think we ought to think about the government advertising in the newspapers. Can't we conceive of something that would counteract these boilerroom operations by advertising or enlisting the aid of the American public education system. I think there should be in the high schools of this country, even in the grammar schools, some education about the fraud that their parents have to be aware of.

That is my final suggestion, Senator. I want to say, again, we are appreciative, grateful, and applaud the efforts of this subcommittee over the years to help the American investing public, and it has been a real pleasure working with you and your fine staff, especially the Chief Counsel, Cass Weiland, former Deputy Chief Counsel Rod Smith, Carol Fox, and Phil Ward. It has been a real pleasure. I hope the efforts of all of us will result in help to the American public.

Senator RUDMAN. Thank you for your kind statements about the staff. I certainly share your sentiments. We want to commend you and Mr. Abrams, attorney general of the State of New York, for the leadership that the State of New York has taken. I think that is significant; I think it is important because New York is the financial center of this country. There are very few problems that exist in the country that you have not seen in New York, in many cases, before the rest of us have. I don't envy you that, but that is just the way it is.

We will look closely at the legislation and also pay heed to your suggestions.

I have a few questions. Most of you have covered in your very excellent testimony the things we hoped you would. Let me just ask you collectively a few questions that come to mind.

Are there any estimates on the number of known boilerrooms, in your respective jurisdictions? We have an estimate, and estimates are hard in many ways to quantify, that there are about 8,000 in the country, a majority of which are located now in Florida, southern California, and I assume New York. Do you have an estimate of what you might have in your respective States?

Mr. FUCHS. Senator, we subpenaed from Southern Bell Telephone Co. a listing of all commodity and oil and gas dealers subscribing to WATTS lines in south Florida. We received back 493 pages. That includes a number of obviously legitimate operations, but we estimate that when we finish gleaning this list, we will be able to identify at least 200 currently subscribing to telephones in Broward and Dade Counties.

Senator RUDMAN. How many in those two counties?

Mr. FUCHS. Approximately 200.

Senator RUDMAN. That would not be registered with CFTC?

Mr. FUCHS. Yes, sir. Some of these are not even incorporated. They include the phrase incorporated in their name and may call themselves incorporated, but we are finding some that are not incorporated. We are finding obviously many that are incorporated. Almost none that are registered.

Ms. WOLF. As I said before, Senator, California is new. Right now, I can only identify about 20 or 25. However, let me say that is misleading because they close and open, reopen and close under different names. It is very hard to keep track of the numbers. I am just hoping it isn't what Florida has been experiencing.

Mr. MIHALY. I can honestly say, Senator, I have no idea how many boilerrooms are in New York. I think virtually the gold and silver metals dealers are virtually out of New York. If they are still there, we will find out about them soon enough.

Senator RUDMAN. I wonder, Mr. Anderson, if you could tell us about Florida's proposed boilerroom bill and also the model uniform State law being proposed by the North American Securities Association?

Mr. ANDERSON. Senator, the Florida proposal is modeled generally after New York's legislation. What we have tried to do is to prohibit boilerroom activity, as we have proposed to define it. Further, to broaden the definition under the Florida Securities Act of an investment, meaning any investment for economic benefit. That way, we can overcome any jurisdictional problems as to whether or not item *x* is a security or commodity or whatever, anyone might want to determine it is. We have further designated our agency, the department of banking and finance, as the agency to deal with the off-exchange firms not registered with the CFTC.

Speaking as chairman of the NASAA Commodities Committee, as a result of the CFTC's new leverage rules, we had a meeting with the CFTC and the National Futures Association whereby we formed a working group comprised of representatives of the CFTC and the NFA. What we are proposing is to fill the cracks between the CFTC's grandfathering in of leverage companies, that is, companies offering essentially metals contracts 10 years or more which would be regulated by the CFTC with any contract less than 10 years falling to the States. We are in a drafting stage right now. We anticipate that we will have something ready for public comment by the time NASAA's convention meets in September of this year.

This, of course, is just model legislation that any State could look to as an example of something they could attempt to introduce in their particular jurisdiction. Further, I think it is important that not only New York's legislation pass, but Florida's, also. If New York and Florida acting as the lead in trying to deal with boilerroom activity of any sort, at least that is what our perspective is, we feel we can assist greatly in trying to stamp out this sort of activity.

Senator RUDMAN. Are you all in general agreement that criminal prosecution is one of the key elements to solving this problem, or at least trying to control it?

Mr. ANDERSON. Yes, sir.

Mr. FUCHS. I would like to address that briefly, Senator, if I might. Florida's comptroller, Gerald Lewis, has taken an aggressive stance in regard to these boilerrooms. Of course, he only has civil and administrative authority. We are not as fortunate as New York to include criminal. Two points come to mind.

First, as my colleague from New York represented, we have to create jeopardy for the individual salesmen, as well as the principals of these companies. They are, after all, the ones perpetrating frauds directly upon these innocent victims.

In trying to do that, there had been some local prosecutorial actions in Florida. I came to Comptroller Lewis' office from the Florida Department of Law Enforcement, and for approximately a year, I was loaned to the office of the State attorney in the Miami area, Ms. Janet Reno. She wanted to aggressively attack boilerrooms in Dade County, as a local prosecutor and borrow the expertise from the department of law enforcement.

The individual that we targeted, whom we had the most information on at the time was one Phillip Grabarnick. Mr. Grabarnick is familiar to the subcommittee from the 1982 hearings. He had been involved with land sales operations with Florida Clearing and Development Corp. and then commodities with Green Valley Foods and other corporations.

I worked with two assistant State attorneys for approximately 12 months and Mr. Grabarnick was arrested on multiple felony charges, including first degree grand theft and perjury. Eventually he received 3 years' probation.

During his probation period, he was allegedly, according to the CFTC, surreptitiously engaged in commodity sales. They have a suit pending against him at this time on that point. Since his probation expired, he has formed International Metals Alliance, Inc., and presumably is in the sale of precious metals. So it is not only a question of enforcing, but as you pointed out yourself, it is a question of educating the judiciary and having reasonable sentences on these people.

Senator RUDMAN. I take it you all agree criminal prosecution is the underlying key here?

Ms. WOLF. Yes, sir, along with public education.

Senator RUDMAN. I would agree with that. I think that pretty much winds up the discussion I wanted to have. I want to thank you all very much for coming here, in some cases long distances, to testify before the subcommittee. Your testimony has been very helpful. I want to assure you that this is a matter we will continue to pursue.

As you all know, last year we made some progress, and we will have to continue it. You all have fairly substantial, legitimate securities industries in your own State, certainly in New York. The key, I believe, is to work with that industry to try to take care of their concerns and assure them that we will not end up with the situation which they fear—a State securities administrator who, for reasons best known to himself or herself, would use those securities laws in a way they were never intended to be used, against legitimate operators who really come under the jurisdiction of the SEC or CFTC. That is a difficult problem to deal with, but I think it can be dealt with particularly if we work with the industry. Thank you all very much for being here today.

We are going to move on to panel III, for what will be a reasonably brief period of time. The panel is comprised of David Vickers, who is a fraud victim from Paris, Tex.; Walter Head, who is also a fraud victim from Destin, Fla.; and Michael Flynn, our staff investigator.

Gentlemen, if you would like to remain standing for just one moment. We have a rule in the subcommittee that all witnesses take an oath. Raise your right hands.

Do you swear the testimony you are about to give in the course of this hearing will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. VICKERS. I do.

Mr. HEAD. I do.

Mr. FLYNN. I do.

Senator RUDMAN. You may be seated. I think we will proceed with our staff investigator, Mr. Flynn.

TESTIMONY OF DAVID VICKERS, FRAUD VICTIM, PARIS, TEX.; WALTER HEAD, FRAUD VICTIM, DESTIN, FLA.; AND MICHAEL FLYNN, STAFF INVESTIGATOR, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. FLYNN. Good morning. My name is Michael Flynn, and I am a postal inspector assigned as a staff investigator to the subcommittee's investigation into commodity fraud in the boilerroom industry. I will make some brief, general observations regarding commodity fraud victims which we found during our review. In preparation for this hearing, members of the subcommittee staff sought to find victims of con artists who operate precious metals frauds. Various Federal, State, and local agencies provided us with an enormous number of letters from people located in every geographic region of the country. Interestingly, no special segments of society appear to be represented in this victim group we reviewed, and I would find it difficult today to draw a profile of the typical white-collar investor or the typical investor in any precious metals.

It became apparent early in our investigation that people from all social, economic, and educational backgrounds are being victimized by these frauds. While a surprising number of highly educated professionals, such as physicians and engineers, were caught in these scams, not so surprising a high number of retirees were victimized. Many of the older victims have fixed savings, especially widows, and are taken because the con artists play on their fear of not having sufficient income to see them through their retirement years.

Whoever the victim may be, each had an amount of money they believed they needed to invest, and the con artists were eager to help them. As the boilerroom sales manager so accurately defined it on the tape we heard earlier this morning, a qualified buyer is the guy who has got the money. Many victims we spoke with were angry because they were lulled into a sense of security after reading daily advertisements over a period of many months. Regular readers of the Wall Street Journal and Los Angeles Times told us why they could not understand why publishers would not screen out advertisers who would defraud the public. Other victims believe now they were lulled into their precious metals investment through impressive mailing advertisements.

Many investors of a California company known as Bullion Reserve told of how slickly produced brochures, self-serving newsletters, statements of accounts received each month made them feel secure in their investment. However, none of them ever saw metal or return for their investment.

Most of the victims we interviewed were defrauded in the classic boilerroom manner—a telephone call from the salesman without a face. Some victims received calls after sending in a coupon from a newspaper ad or telephoned a toll-free number seen in the same ad. Others received what is referred to in the industry as a cold call from a salesman unsolicited and unsuspecting.

Victims are led to believe a precious metal investment has minimal risk, and eventually the salesman or brokers, as they are called, will make money for them. It is unusual to find any victim who invested based on only one phone call. The vast majority of victims recall several conversations with their salesmen or brokers who made heavy sales pitches laced with misrepresentations and false statements.

With us here today are two gentlemen who invested with two different companies and gladly accepted the invitation to come to Washington and testify today about their experiences.

At the far end of the table is Mr. Walter Head from Destin, Fla., and on my immediate right is David Vickers of Paris, Tex.

Senator RUDMAN. Thank you very much. Since your statements are brief and they do represent, I think, very important statements on your experiences, you certainly may read them in full. We will proceed, with Mr. Head, if you would like to go first. If you would pull the microphone in front of you, that will be fine. Take your time.

Mr. HEAD. I want to say first that I identify very strongly with the two previous speakers a while ago, Dorene Wolf and Orestes Mihaly. I identify very strongly. They named a person that was typical of myself.

My name is Walter Head. I am 57 years old, and I live with my wife and two sons in Destin, Fla. That is 45 miles, approximately, east of Pensacola. I am a retired pharmaceutical chemist and also operated my own store for a few years.

In September 1981, I received in the mail an unsolicated advertisement from Bullion Reserve of North America. Since I had been a successful investor in silver a couple of years ago, in 1977 and 1978, I was interested in purchasing silver again as an investment. So I telephoned Bullion Reserve's toll-free number, which they mailed to me in the first mailing. They mailed additional information to me, and after studying this information and having subscribed to various economic newsletters, I decided to use them to make a purchase of further silver. The fact that determined my selection of Bullion Reserve of North America was primarily at first that they used a method of storage of silver that I was familiar with. They used Perpetual Storage vault in the Wasatch Mountains of Utah which I had read as being one of the safest depositories in the world.

I wanted to store my metal in a safe place rather than take possession. Second, Bullion Reserve of North America advertised in their brochures that they dealt only with Johnson Matthey assayed silver. Engelhardt and Johnson Matthey I already knew were one of the two world's best and respected refiners of silver. You would not have to have these assayed on a resale of their stamp metals. So I chose Bullion Reserve of North America.

As I said, I had read about Perpetual Storage. That was a strong incentive. I could rely on the word of these two companies that Bullion Reserve supposedly did business with, so there was no reason for me to do much further checking into their reputations.

So, on December 24, 1981, I telephoned Bullion Reserve at their toll-free number and purchased $2,000 in gold at $400 an ounce. This was my own savings. I again called on March 19, 1982, and purchased $5,000 which was the remainder of my entire 15-year savings account in my family at $7.03 an ounce. My total investment of my own life savings was $7,000 at this point. This represented 15 years of my savings, and I used this for emergency needs and counted on it, that is why I wanted an investment that was liquid, that could be resold safely or kept invested, either way I chose.

Although I am a talkative person sometimes, the salesman with Bullion Reserve of North America was the very opposite of the tape recording that was played here earlier. They were very professional sounding. They didn't talk any more than was necessary to get the business done. This impressed me. They told me the confirmation of any purchases would be sent in the mail and that I was purchasing at the exact daily stock price of the metal at the time of my telephone call. They asked me to send a check to them within 12 hours to secure that spot price which I did, and they inquired if I desired possession or vault storage at all times. Of course, I asked for vault storage, so within about 3 days of each order, I received a confirmation of the sale.

During the summer of 1982, I continued to read literature about precious metals investment and noted the daily market prices. I had kept my own personal chart for over 8 years in these metals. I kept a chart on gold and silver in particular. There was a forecast for steady rises in these metals over the next several months. Therefore, I explained to my sister and my mother, my elderly mother, 79 years old, that I was certain that some money that my mother had should be put into silver at this time, that it would be very safe.

Finally, I persuaded her to invest $20,000 in silver, which I used with Bullion Reserve of North America also. My mother only had another $20,000. That was her life savings from the death of my father, and the sale of some real estate.

In February and March 1983, I did a stupid thing. I persuaded them to put that other $20,000 into silver because the silver was going up all this time. I was doing very well on my own $7,000 investment. I made these purchases in her name in the same way that I had made my purchases, using the toll-free number. Over these months that I had this investment, I received monthly statements, very impressively printed, just like a topnotch bank, from Bullion Reserve that gave a complete detailed amount of my purchases and what they were valued at at the daily price currently of silver or gold.

I had read several newsletters that this company was still reliable. In October 1983, I called Bullion Reserve on their toll-free number in order to redeem part of my silver for a little emergency use, and I was shocked more than I have ever been shocked in my entire life when I heard the message on a tape that the company had filed bankruptcy and then a little later, I learned of the death of the company president, Allan Saxon.

In conclusion, I hope my testimony here today and presence here today will be effective in producing some kind of effective legislation that will prevent this from happening to other people like myself. Again, I want to commend those two previous speakers, Dorene Wolf and Orestes Mihaly. They gave very good presentations, and I do believe that the regulatory agency that should be instilled in these has to be of a national nature. I am in the medical field. State boards I am familiar with. These companies deal on a national basis. Doctors and pharmaceutical chemists like myself confine ourselves to the State. We can be regulated very easily by the State, AMA, and State Boards of Pharmacy. This cannot be regulated by each State. It must be a national organization that has criminal prosecution abilities. I am positive of that.

Senator RUDMAN. Thank you very much, Mr. Head. We really appreciate your coming here today. I know it is difficult for you to recount these stories, and we are most appreciative.

I want to ask you just one question, and it is a question not in any way critical in nature. It is to try to understand how these things happen. First, you might just help me with one bit of geographical information which will underline my question. Where is Destin, Fla.?

Mr. HEAD. Everybody asks that question. Don't feel bad. It's a little fishing village they used to call it. It's growing crazy, 5 miles from Fort Walton Beach, Fla. Fort Walton Beach is noted a little more than Destin, but it's only 5 miles directly south, right on the gulf before Walton Beach, Fla.

Senator RUDMAN. What would be the major city—

Mr. HEAD [interposing]. Pensacola.

Senator RUDMAN. Here is my question. You could have purchased exactly what you purchased from a number of nationally known, very good firms, national brokerage firms that deal across the broad spectrum of stocks, bonds, securities of all sorts, gold, and silver. Obviously you had been studying this market and keeping charts, and I guess we would have to say you were probably more informed about the market than many.

Mr. HEAD. Yes.

Senator RUDMAN. Why did you choose this paticular company as opposed to going to a nationally known firm that was obviously legitimate and financially strong?

Mr. HEAD. Most of the other firms that I had studied usually made a rule that you took possession of gold and silver. I highly recommend these firms now, but I wanted an investment where the storage was very safe. The others that stored didn't give any information about how they stored it. They usually just recommend you take possession and put it in a safe deposit box. Bullion Reserve of North America was the only one that I received any information about that gave a topnotch storage facility. As it turned out, they didn't deposit all of the money in Perpetual Storage. The money they did deposit there, I am sure, is redeemable and safe in the proceedings against the company now. They didn't deposit all of this money in this Perpetual Storage in Wasatch Mountains. So they were practically the first consideration that I gave at that time.

This money was money that I had to keep very liquid. My mother is elderly and we might need $5,000 or $6,000 or $8,000 at any given moment, and I wanted it to be stored safely, and they had a buy on safe, ironclad, fast transactions; I just chose them on that basis.

Senator RUDMAN. Are you going to receive any recovery at all in this case?

Mr. HEAD. That's what I am dearly wanting to find out. I am glad you mentioned that because I only received one little brochure from the Bankruptcy Court a week after I had learned about it from the tape on the telephone saying that it would be likely many months before the first unraveling would take place and then many more months before any settlement could possibly be made.

Senator **Rudman**. I believe our chief counsel might say something for the record on that point.

Mr. **Weiland**. Mr. Chairman, we have been in touch with the bankruptcy trustee for the Bullion Reserve of North America, Mr. Curtis Danning in Los Angeles. While he is still busy at work trying to marshal assets, his report to us informally is that the investor should not expect any kind of a significant return.

Mr. **Head**. That relieves my mind in a terrible way, let's put it that way. What I wanted to know was—this, in my particular instance, is going to affect the rest of my life. I am going to have to restructure the whole entire plans of my family, myself, my mother, and possibly my sister because this was money that we had planned to use in various investment ways and various material ways over the rest of our lives. So I wanted to know whether I had any prospect of getting a certain amount back so that I would know how to restructure my life. If I don't get any back, I am going to have to really drastically restructure my life.

Senator **Rudman**. Mr. Head, our information is obviously not final. I did want to place it in the record. We are going to have a witness here tomorrow who is the former wife of the deceased president of that company, Mr. Saxon. I think that in all of these cases we will find that a large amount of the money that was taken in from investors, rather than being handled legitimately, as it is handled by most major firms, was diverted for other purposes on the hopes there would be a continued rise in the market. There was a great deal of speculation done in other fields, and, obviously, much of the money was lost. What is in hard assets is going to be very small.

We thank you very much for your being willing to appear, and we will now ask to hear from David Vickers from Paris, Texas. I am going to place in the record at this point a newspaper report from the Fort Lauderdale News Sun-Sentinel, dated January 29, 1984, entitled, "Universal Metals: Classic Boiler Room."

[The newspaper article referred to follows:]

Universal Metals: Classic Boiler Room

(By Dan Lovely and Buddy Nevins)

With high-pressure hype and phony advice, the now-closed Universal Precious Metals was the classic example of a telephone boiler room.

"We're not in the business of giving money. We're in the business of getting money" was Universal's philosophy, salesman Guyton North told the Federal Commodities Futures Trading Commission.

After Universal closed in December 1982, federal authorities said customers had lost $5.8 million through "illegal commodities futures contracts . . . fraudulently offered and sold."

The Florida Comptroller's Office, currently investigating about 25 South Florida precious-metals firms, warns investors that "a typical commodities fraud" works this way:

Most precious-metals trading is done on margin—the investor puts up only a portion of the money needed to buy the metals.

"Soon the victim gets a soothing phone call from the broker saying the price is going up and that they have reinvested the investor's profits in more metals," the

Comptroller's Office said. "Suddenly prices drop and the company calls the victim saying they owe them the money to cover the margin and the loss.

"Although the firm collects the money they say is owed them, they never purchased any metals for the investor."

Such precious-metals companies operate from "boiler rooms": usually "rented rooms crammed with desks and phones" and salesmen "hired for their brazen persistence alone," a U.S. Senate subcommittee found.

At Universal Precious Metals, salesmen were told to "hype the market," salesman John Little told the CFTC. "You've got to show them it's shaking and moving."

Although salesmen informed customers Universal had a research department, none existed. Instead they offered market advice "off the top of their head," Little testified.

The CFTC contended Universal salesmen "lure cutomers into purchasing Universal contracts . . . by misrepresenting various world and market events."

Federal investigators reported a typical Universal sales pitch:

"We're getting indications from our overseas and our domestic analysts that this is going to be a bull market, and if you want to make 2-300 percent profit on your money, in a very short time, I think now is the time to do it."

But Universal salesmen didn't even know whether they were quoting customers actual market price for the metals being sold—because the figures came over an inhouse television system. They also testified that sales manager Jack Rose occasionally sent an obscene message threatening to lock salesmen in the office until they reached $50,000 in sales.

Discussing precious metals boiler rooms at 1982 U.S. Senate hearings, Norris Penland, a South Florida mail fraud investigator for 12 years, offered this advice:

"I believe any product which can be sold by a faceless voice on a telephone is available in better quality, at a lower cost, in a location where the buyer meets the seller face to face."

Senator RUDMAN. You may proceed, Mr. Vickers.

Mr. VICKERS. My name is David Vickers. I am 37 years old, and I live with my wife and two sons in Paris, Tex., approximately 125 miles northeast of Dallas.

Senator RUDMAN. Please pull the mike a little closer to you.

Mr. VICKERS. I presently own and operate a small business selling computer software and home computer supplies.

I feel I should briefly explain my work background and why I made investments in precious metals at a fairly young age. For most of my adult life, 13 years to be exact, I worked for the railroad. In March 1980, I suffered a back injury while doing work at a derailment site. The injury kept me in and out of the hospital for approximately a year and a half. I was later told by the Sante Fe doctors and my personal doctors that I could no longer work as a brakeman. Being qualified for other railroad jobs, I could not draw disability income without 20 years of service. In July 1982, I received a settlement from the railroad, but I now had to go out and find a new occupation to support my family.

While I was in the hospital, I began to study the personal computer market and continued to study while recovering at home through 1982. After losing my investments with UPM and National Monetary Fund, and after Texas rehabilitation failed to have other job opportunities for me, I opened my own business with what was left of the settlement.

I never have had a large amount of money for long-term investments because I had steady employment and didn't have time to consider such things, but I quickly realized I needed to make some investment decisions and decided to invest in precious metals and money market funds.

The two precious metals firms I dealt with were Universal Precious Metals and National Monetary Fund.

About the middle of August 1982, I received an unsolicited telephone call from a salesman for Universal Precious Metals. He told me how the gold and silver market was about to take off due to events in Iran and other factors which were affecting the market.

[At this point in the hearing, Senator Chiles entered the hearing room.]

Mr. VICKERS. I told him I was interested and I had already invested with National Monetary Fund and that I would get back with him later. I received several more telephone calls over the next 2 weeks from the same person. In the meantime, I read articles in publications, such as Forbes and Money magazines which were very optimistic about the gold and silver market. I contacted the Securities and Exchange Commission in Washington, D.C., and asked about Universal Precious Metals and National Monetary Fund. I was told that there were no complaints or charges against either of these firms and they referred me to the Better Business Bureau in Miami, Fla.

The also told me that Universal Precious Metals had been in business for 3 years and National Monetary Fund for 7 years.

They also told me there were no charges or complaints against either company.

As a result of my conversations with the salesman and satisfied with my own investigation, I decided to invest in silver because I didn't have to risk as much money. So I wired them $4,201. The silver went down and I received a phone call from the salesman and he said he was sorry about the silver and offered to negate the loss and credit my account with $4,201 if I would switch into a gold contract. So I did, and I had to wire them an additional $10,247 to control 150 ounces of gold. The salesman asked if I wanted to take possession of the metal and I told him no because I only wanted a contract and did not want physical possession. I never intended to take possession, but simply wanted to buy into and get out of the market at the appropriate time.

During this time, the salesman was very interested in keeping me satisfied and told me that I would get my initial investment back within 90 days and that I could triple my money in 3 months. During this time, I continued to monitor the gold market and in November 1982, gold reached $519 an ounce and I decided to take my profit and get out.

When I saw this, I called UPM and told the salesman I wanted to sell my contract, but he wanted me to hold off because he believed the market was going higher. Within a matter of days after the call, I learned about the bankruptcy of the company and realized my investment was lost.

As I mentioned earlier, I made another investment of precious metals with National Monetary Fund in Miami, Fla. At the same time, I was investing with Universal Precious Metals, I invested with the National Monetary Fund and sent them $10,000. Although that company later went bankrupt, I was able to recover approximately $1,300 through receivership that was still in the account at the time of bankruptcy.

I realize now that both of these precious metal companies were frauds and I am still trying to recover from this experience. I feel I was in an unfamiliar situation, no job or income security, and with a fixed sum of money and limited investment experience, I believe I did the best I could do to minimize the risks involved.

Senator **Rudman**. Thank you, Mr. Vickers. We also appreciate your coming up here today to testify. I am sure it is difficult, but your testimony might help others.

Let me ask you the same question I asked Mr. Head. Did you ever give consideration to making this investment through one of the nationally known firms that dealt across the broad range of securities?

Mr. **Vickers**. No, sir; I didn't. I read most of the publications I could get my hands on at the time, and I investigated money market funds, I sent for prospectuses and I did all the preparation that I believe I could do with these commodity companies.

Senator **Rudman**. Senator Chiles, do you have any questions for either of the witnesses?

Senator **Chiles**. No.

Senator **Rudman**. Because Mr. Vickers has been talking about Universal Precious Metals, I am going to enter in the record at this point that we attempted to get both Mr. David Bentley and Mr. Jack Rose, principals in that company, to testify. We received communications dated the 13th of March, which I believe followed some conversations that our staff had with Mr. Jack A. Field, from the law firm, Field & Halfhill of Alexandria, Va., essentially telling us on behalf of both Mr. Bentley and Mr. Rose that they would, upon advice of counsel, invoke their privilege against self-incrimination under the fifth amendment. The explanation for that is based upon the fact that Mr. Field's clients have been advised that there is a Federal grand jury underway in the northern district of Illinois, and that in both cases, these gentleman, Mr. Bentley and Mr. Rose, are targets of that investigation.

We will enter those communications from Attorney Field in the record at this time.

[The correspondence referred to was marked "Exhibit No. 3," for reference, and follows:]

EXHIBIT No. 3

FIELD & HALFHILL,
ATTORNEYS AT LAW,
Alexandria, Va., March 13, 1984.

S. CASS WEILAND,
Chief Counsel, U.S. Senate, Senate Permanent Subcommittee on Investigations, Russell Senate Office Building, Washington, D.C.

DEAR MR. WEILAND: In response to your letter of February 24, 1984 concerning my client David Bentley, I have now had the opportunity to communicate with Mr. Bentley and he has requested that I advise you that reluctantly, upon advice of counsel, he will invoke his privilege against self-incrimination guaranteed to him under the Fifth Amendment to the United States Constitution with respect to any inquiry related to the operation of Universal Precious Metals, Inc.

This Fifth Amendment invocation is not made lightly nor with the attempt on the part of Mr. Bentley to avoid legitimate inquiry by the Committee; but, rather is based upon the fact that he has been advised there is a Federal Grand Jury investigation under way in the Northern District of Illinois and that he is a target of this Federal Grand Jury investigation.

Based upon Mr. Bentley's intention to assert his Fifth Amendment privilege if called before the Subcommittee, it is my understanding that no subpoena will be issued to him and that he need not make arrangements to appear on March 19 or 21, 1984.

Very truly yours,

JOHN A. FIELD III.

FIELD & HALFHILL,
Attorneys at Law,
Alexandria, Va., March 13, 1984.

S. CASS WEILAND,
Chief Counsel, U.S. Senate, Senate Permanent Subcommittee on Investigations, Russell Senate Office Building, Washington, D.C.

DEAR MR. WEILAND: In response to your letter of February 24, 1984 concerning my client Jack Rose, I have now had the opportunity to communicate with Mr. Rose and he has requested that I advise you that reluctantly, upon advice of counsel, he will invoke his privilege against self-incrimination guaranteed to him under the Fifth Amendment to the United States Constitution with respect to any inquiry related to the operation of Universal Precious Metals, Inc.

This Fifth Amendment invocation is not made lightly nor with the attempt on the part of Mr. Rose to avoid legitimate inquiry by the Committee; but, rather is based upon the fact that he has been advised there is a Federal Grand Jury investigation under way in the Northern District of Illinois and that he is a target of this Federal Grand Jury investigation.

Based upon Mr. Rose's intention to assert his Fifth Amendment privilege if called before the Subcommittee, it is my understanding that no subpoena will be issued to him and that he need not make arrangements to appear on March 19 or 21, 1984.

Very truly yours,

JOHN A. FIELD III.

Senator **RUDMAN**. Thank you very much for appearing today. We will next call forward our third panel, Mr. Earl Faircloth who is the trustee in bankruptcy for International Gold Bullion Exchange, Fort Lauderdale, Fla., and Mr. William Nortman who is a receiver, court appointed for Universal Precious Metals, Miami, Fla.

Gentleman, we do have a procedure of administering the oath. Do you swear the testimony you are about to give in the course of this hearing shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **FAIRCLOTH**. I do.

Mr. **NORTMAN**. I do.

Senator **RUDMAN**. We welcome you both. I particularly want to welcome Mr. Faircloth. I believe he and I served as attorneys general of our States at the same time back in the early 1970's. I am delighted to see you again.

Senator **CHILES**. Mr. Chairman, I want to express my welcome to General Faircloth. We have had associations that go back many years, service together in the State legislature before he aspired to attorney general, and we are delighted to have him here today.

Mr. **FAIRCLOTH**. Thank you, Senator, very much.

Senator **RUDMAN**. We are pleased to have you here because as court-appointed receivers and trustees in these matters, we believe you might have some information that would be helpful to the subcommittee for the record. You have been here for the hearings this morning, and I think you have a sense of the problem that we are facing nationally.

I think what we will do is, to the extent you want to, just give us in your own words your experiences and views and any other comments you would like to make. Mr. Faircloth, your statement will be put in the record.[1] We will call first on Mr. Faircloth and then on Mr. Nortman.

TESTIMONY OF EARL FAIRCLOTH, BANKRUPTCY TRUSTEE, INTERNATIONAL GOLD BULLION EXCHANGE, FORT LAUDERDALE, FLA., AND WILLIAM NORTMAN, RECEIVER, UNIVERSAL PRECIOUS METALS, MIAMI, FLA.

Mr. **Faircloth**. Senator Rudman, Senator Chiles, and your able and efficient staff members, about 1979, a fellow by the name of William Alderdice——

Senator **Rudman** [interposing]. You might pull the microphone a bit closer, and I think it will be easier for all of us.

Mr. **Faircloth** [continuing]. Had a sort of pawnshop operation in Clearwater, Fla., as I understand, and in 1980, he came to Fort Lauderdale and continued his pawnshop operation, but gradually worked into the gold bullion business.

By the simple expedient of forming a corporation called International Gold Bullion, Inc., of Florida and at the same time he formed one in Texas by the same name and in California by the same name, and by the simple expedient of going down to the county clerk's office, he procured a business occupation license and without any other investigations, as far as I have been able to uncover, or other restrictions or retardation whatsoever, he entered business and started large-scale advertising in the great newspapers of the country, offering to sell gold for less than spot price and other inducements.

He would also offer to keep your gold and pay even 1.5 percent up to 2.5, 3 percent per month. That was to enable him to have a delayed delivery. He formed these three corporations and, as I said, he operated in Fort Lauderdale, in Dallas, and in Los Angeles. He started when gold was at a very high figure. I don't remember the figures and the years, but his admitted practice was he would take an order for, say, gold at $612 and then he would immediately send out a reply acknowledging receipt of the money at $612, or whatever it was, and then have them enter into a program of delivery 90 days later, and maybe he would fill the order at $575 or less.

He frankly admitted to us as long as the price of gold was falling, he was all right. He had a large amount of money to deal with. But when gold leveled off or even started up, he was in trouble because he couldn't fill the orders. The modus operandi was roughly that, and in 1982, late 1982, the customers began to complain to the local law enforcement people, the State attorney's office in Fort Lauderdale and the police generally. As a result, in March 1983, the comptroller of the State of Florida and the attorney general of the State of Florida sought the appointment of a State receiver, which was done, and they closed them down.

A few weeks later, they took Federal bankruptcy under chapter 11 proceedings, and after operating as a debtor in possession for a short while, the Federal bankruptcy judge appointed me as trustee to take over in March the assets.

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[1] See p. 133 for the prepared statement of Earl Faircloth.

The assets I have been able to marshal to date are about $400,000. We have served turnover orders on dozens of banks in the country. We have followed any lead we could get as to where assets were. We have had great cooperation from the State attorney's office in Broward County, Fla., from the State attorney general of Florida, the Comptroller, the FBI has been very helpful but with all of that help, we just haven't been able to find any assets. It's gone.

We have been retarded, somewhat, in the inability to have an audit made. National accounting firms have inspected the premises and the records which we have been able to exhibit to them and on a preliminary basis estimate that the cost of an audit would be better than a half a million dollars by the mere number of documents involved.

There are at least 25,000 to 30,000 key documents which I believe are referred to as the yellow sheet. It is a copy of the invoice. On that yellow sheet are 11 or 12 symbols in handwriting which mean something to the gold bullion operator but nothing to us. We hopefully have been able to decipher something, but our limited personnel and lack of money is barely enough to pay needed expenses in the administration of the estate and the preferred or the claims that have to be attended.

So we only have one asset that bears any possibility of fruition, and that was the organizers spent company money and bought for a million and a half dollars an 85 percent interest in a limited partnership which was engaged in a gold mine venture in Alaska. All kinds of favorable reports of governmental publications about the value of this area underneath the water at the mouth of a little creek east of Nome. It is fabulously wealthy, according to reports, and right now, we are pursuing every avenue we can to keep the hopes alive that that can be made into something that would give the creditors something, maybe everything if it is as rich as reported it would be.

But otherwise, the creditors, I don't believe, will get anything at all.

Senator **Rudman**. What is the size of the claim against the estate?

Mr. **Faircloth**. Originally—well, we have 23,700 creditors who have been registered as having claims; 13,000 plus of those 23,000 have made claims totaling more than $75 million. During the year of 1982, the record we have been able to uncover would indicate that they have a gross income of $82 million during 1982, and the overhead we have been able to estimate—well, it was tremendous, but it wouldn't account for the disappearance of that much money.

Senator **Rudman**. Have you been able to trace in any way what Mr. Alderdice might have done with any of these funds? Was there gambling or speculation of any kind involved?

Mr. **Faircloth**. There were 38 subsidiary corporations, and we have procured a turnover of the stock in 25 of them and pursued that, and we recovered a total of $12,000. They operated these subsidary corporations and they threw away a lot of money in them, but not to the extent that it would account for what appears to be an enormous amount of money.

Senator RUDMAN. General Faircloth, with your distinguished record in public service and also as a private attorney, as you look at the state of the law, both in Florida and federally, would you like to make any observations at this point?

Mr. FAIRCLOTH. Yes, sir, I think Senator Chiles would agree that in Florida, the State would make a much more vigorous examination of an applicant for a liquor license than they do for the occupational license to deal in precious metals. It would be immensely more difficult to be a beautician in Florida than to be a precious metals operator. So I think that is the first step. Anybody entering into that business ought to have the scrutiny of a Federal agency, certainly a State agency, maybe both.

Additionally, I agree with everything I have heard and the necessity for more vigorous and more effective criminal prosecution. Our creditors who call by the dozens every day to find out what is going on, one from Colorado in the early days wanted to know when he could come down and pick up his $25,000 coin collection which was in the vault, and I had to tell him when we took over there were two old typewriters and about 30 gold bars, but they were wood painted gold in the vault. He said, "Well, where is my coin collection?" Why he sent it in was he was going to get interest on the value of it. They just simply did away with it.

There also was an insurance company which carried a heavy, heavy policy against robbery from within the vault apparently, although there is some question about whether that is insured, and we may talk with them later, but they required a certification under oath by the owners every month as to the contents of that vault.

Less than a month before the State closed it down, that certification was that there was over $5 million in gold bullion or gold in that vault. We didn't find anything. It had gone someplace. I think the more effective thing would be a State or Federal regulation to have a system of reporting which would be verifiable by some authority because these people were, as has been said, they were a loose cannon on the deck of a consumer ship. Somebody needs to look at this every now and then to let them know somebody is watching them.

Senator RUDMAN. Certainly nobody was looking in this case, and most cases we have had. I think your analogy about the difficulty of getting a license to do certain other mild occupations and professions is right on target. That is the problem. Senator Chiles.

Senator CHILES. General, I note that you mention in your testimony there may have been the possibility of some offshore dealings. Have you been able to get into that at all?

Mr. FAIRCLOTH. We tried. The best source of information is the Fort Lauderdale State Attorney's Office because it turns out that they had been watching these people from the very beginning. They haven't turned up anything. We have investigations still going, but so far we haven't found anything.

Senator CHILES. Am I correct in filing for a chapter 11, that would be an arrangement of creditors to continue to run the operation, so they actually were so bold——

Mr. FAIRCLOTH [interposing]. They filed a chapter 11 and sought to operate as the debtor in possession, but the Federal bankruptcy judge didn't allow that but a couple weeks before he appointed his own trustee.

Senator CHILES. I understand that. When they subjected themselves or placed themselves into a chapter 11, does that give the bankruptcy judge the authority to depose them under oath, question them under oath?

Mr. FAIRCLOTH. Yes; indeed.

Senator CHILES. Has that been done?

Mr. FAIRCLOTH. We are in the process of doing it.

Senator CHILES. You are in the process?

Mr. FAIRCLOTH. Yes.

Senator CHILES. I am trying to, from my impression, determine if these people are subject, at least, to being interrogated under oath as to what they say happened to the $75 million, or whatever the amount is, over $75 million in claims——

Senator RUDMAN [interposing]. I believe it went from a chapter 11 under a full bankruptcy.

Mr. FAIRCLOTH. Yes; that is correct, the bankruptcy laws, I believe, are very thorough and hopefully——

Senator CHILES [interposing]. So you don't see any problem there now?

Mr. FAIRCLOTH. No; I don't.

Senator CHILES. Will you be pursuing that as the trustee now?

Mr. FAIRCLOTH. Yes, sir, that is correct, and will continue to do so and report to the court periodically and keep them fully informed, and we have enough power, I think, in the Bankruptcy Act to find it if it is around. But the failure, I think, is not in the present bankruptcy law, it is probably not in the present criminal laws. It may be faulty in the application of it, but what is at fault is, no supervision, nobody watching the operation at all.

Senator CHILES. The fact it could go on and take this much of the peoples' money without there being some check——

Mr. FAIRCLOTH [interposing]. I don't think they could ever file a monthly report that wouldn't have alerted everybody to what was going on and you could probably close them down and save a lot of creditors a lot of loss if you had some kind of a reporting system.

Senator CHILES. How long has it been in trusteeship now?

Mr. FAIRCLOTH. I was appointed in late May 1983, less than a year.

Senator CHILES. Less than a year?

Mr. FAIRCLOTH. Yes; we are continuing our investigation, following up any leads, and we are scheduling depositions with all the key people and tracing the money if we can.

Senator CHILES. That is going to be very interesting to see what happens.

Senator RUDMAN. I want to thank you very much, and I guess we would have to wish you luck in your role as a prospector for gold in Alaska, General Faircloth.

Mr. FAIRCLOTH. Thank you, Senator. On behalf of the creditors, I hope we do.

Senator RUDMAN. That is correct. At this point, I would ask our chief counsel to make a brief comment about Mr. Alderdice which should be in the record at this point.

Mr. **Weiland**. William and James Alderdice were indicted by a Federal grand jury in the southern district of Florida and are currently pretrial detainees and are also under indictment in New York.

We have attempted to secure their testimony. Nevertheless, and at one point, they were quite cooperative and eager to appear before the subcommittee and testify. Just recently, however, they changed the lawyers and, frankly, their new counsel has been able to convince them that they should now invoke their fifth amendment privilege—after they have held press conferences, after they have been interviewed by our investigators in Miami, and I would like to enter into the record at this point a very brief letter that was delivered by their new counsel to me last week.

[The letter referred to was marked "Exhibit No. 4," for reference, and follows:]

March 8, 1984.

To whom It May Concern, although in the past I had agreed to cooperate with the Senate subcommittee and testify, upon advice of counsel, I will now, if called, take the fifth amendment.

W. L. Alderdice

It is signed B. L. Alderdice, or W. L. Alderdice.

In any case, Senator, we felt, and you agreed, of course, that it would be fruitless to require him to come to Washington to invoke the fifth amendment.

Senator **Rudman**. And there would be no question of considering immunity because of the seriousness of this?

Mr. **Faircloth**. I say, Mr. Chairman, at the first creditor meeting, Mr. Alderdice involved the fifth amendment more than 50 times. In private conversation, he will tell you what you want to ask him.

Senator **Rudman**. Unfortunately, that doesn't do us very much good. Thank you, General Faircloth.

Senator **Chiles**. Can he invoke the fifth amendment in the bankruptcy proceeding?

Mr. **Faircloth**. Yes, he can. If it affects his criminal rights, criminal liability, he can. If it may incriminate him, he can take the fifth and he did so more than 50 times.

Senator **Rudman**. Thank you very much. We will now hear from William Nortman of Miami, who has been appointed receiver of Universal Precious Metals.

Mr. **Nortman**. Thank you, Senators. The comment Mr. Anderson made this morning about Maggot Mile is very appropriate because as receiver of Universal Precious Metals I have a feeling I was trying to clean up the effects of Maggot Mile.

I was appointed receiver at the end of 1982. I am an equity receiver and as such, my roles and responsibilities are not as carefully demarcated as they would be under the bankruptcy laws.

In any event, what is very interesting about the Universal Precious Metals' situation is that the action that was filed which led to my appointment was filed by the Commodity Futures Trading Commission in early 1982. In September 1982, while UPMI was still in business, and the Commodity Futures Trading Commission action was pending, the Federal Bureau of Investigation, out of Chicago, obtained search warrants out of the southern district of

Florida, and, to use the hackneyed expression, raided the joint, on September 22.

Interestingly, I wasn't appointed until December 1982. So, in effect after the FBI raided UPMI and after they seized voluminous books and records and after they seized a suitcase owned by Mr. Bentley which contained $19,000 in currency as well as items of precious metals, gold, and Treasury bonds, the company, nevertheless, stayed in business for approximately 2½ to 3 months.

The statistics that are interesting are that the accountants, when they reviewed the financial records, advised me that on September 9, 1982, just shortly before the FBI raid, UPMI had approximately $1,476,000 in various banks and had $835,000 balances in various precious metal firms. Needless to say, by the time I was appointed this changed dramatically, so you will find as of December. I was able to obtain approximately $14,784 as distinguished from $1,476,000 from the brokerage firms and the cash in the bank was approximately $24,000.

Needless to say, a lot of money went out the door from the hiatus from the FBI raid until the CFTC was able to obtain a receiver. I might say in fairness to the record that the receiver was appointed by the court upon the consent of the defendants. It was not as if the court itself had decided that a receiver should be appointed, but this is typical in cases such as this whether it is an SEC enforcement proceeding or CFTC enforcement proceeding.

Now I am there with the proverbial poop scoop trying to clean up this mess. The question is "What do you do as an equity receiver when you are faced with a situation like this?" I found we basically have several major functions. We have the formal functions which are fairly well delineated in the order of appointment, which common sense will tell you is to marshal assets, and in addition to that, take action if appropriate in the future.

Well, the first thing we have to do is to establish lines of communication with customers. And I endeavored to notify customers as promptly as possible as to why no one was answering the phone. Indeed, I installed an answering machine until I was able to get what records there were moved out of the premises of UPMI and put it in my accountant's office.

I also found in addition to the formal role, commonsense role, you also take on a scapegoat role as an equity receiver, and it is perfectly understandable. I heard the testimony earlier today and, unfortunately, it is too familiar to me in terms of letters I have received since I have been installed as an equity receiver. And as a result, there is no one that somebody can vent their anger against, so as a consequence, you find very often an equity receiver is charged with having powers which he simply does not have.

I tried to explain to people there just is not enough money available to make everybody whole and, indeed, in most of these situations, there is very little available.

Let me briefly go into what the apparent losses were and the number of customers.

Based upon an overall review of the records, it appeared that UPMI during its existence had approximately 1,500 to 2,000 customers. Fortunately, or unfortunately, as the case may be, when I was installed as a receiver, there were approximately 580 open customer accounts, where it appeared there was some positions in the account and, accordingly, the analysis that was undertaken by myself, counsel, and particularly the accountant who did a fantastic job for me, given the circumstances of the records. This analysis reveals basically what follows:

From their own—UPMI—documentation that we were able to obtain, as of December 3, 1982, it appeared the company acknowledged owing in excess of $3 million to customers. We then did what I call an open analysis of the moneys that came in, precious metals that came in versus moneys that went out or precious metals that went out because it would have been too costly to make an individual analysis of each customer's account and mark that account on a particular day. Using this thumbnail approach, the accountants estimated that the total losses, as I defined them, is approximately $5,800,000. Further, and I think this aptly summarizes many of the abuses we heard about this morning, UPMI as part of its sales literature states—I am now quoting—"in all cases, less any applicable fees, deposit moneys are placed in a segregated bank account. Thereafter, each purchase will be made available for delivery through purchase of delivery contracts or recognized commodity exchanges and/or from recognized dealers and suppliers."

Reading that, it sounds fairly safe. Contrary, however, to what was stated, the practices were markedly different. What I did find was that at UPMI, the firm traded as a principal in gold and silver and copper on a delayed delivery basis similar to the format we heard about this morning. The transactions were, again, similar to what we heard this morning, primarily in gold and silver. A customer generally bought long as opposed to selling and going short, and customers generally did not take delivery of the commodity but sold it back to UPMI prior to the physical delivery date that the contract called for.

Contrary to what I just quoted in UPMI sales literature, customer funds from segregated account were generally transferred to UPMI's payroll or regular account and used to pay corporate and other expenses.

Further, we could not locate any records that indicated that UPMI maintained any physical metals inventory. Moreover, it appeared that any purchases that were made from gold or bullion dealers were of a nominal nature. Further, to echo a point that Senator Rudman made a few moments ago, we did an analysis of the daily commodity trading that was carried on by UPMI through Mr. Bentley from the period December 1981 through November 1982. This analysis indicated that UPMI did not hedge, that is to say, purchase future delivery contracts to cover open customer positions, but rather played the market itself and traded against their customers by going short.

I might add that unfortunately for the customers of UPMI, during the period from November 3, 1981, through December 6, 1982, Mr. Bentley apparently lost approximately $3 million playing the futures market.

We also, as I was charged to do, under the order of appointment, tried to reconstruct an analysis of cash disbursements and receipts. I cannot emphasize too strongly how easy it is to say it and how difficult it was to do. The records were either in Chicago with the

FBI or they were down, to some extent, in Fort Lauderdale. Many were illegible. We had to go back to banks and their copies were not exactly clear, but we managed to put it together and, Senator, you have as exhibit 6 to my letter the report that Oppenheim, Appel, Dixon & Co. prepared.

Senator **RUDMAN**. We are going to make that part of your testimony.

Mr. **NORTMAN**. It did appear Mr. Bentley and Mr. Rose did, I think, by any reasonable standard enjoy a handsome salary. Mr. Bentley was pulling out $7,000 a week and Mr. Rose $5,000 a week.

In addition, as the report indicates, it appeared to the accountants, myself, and my counsel that based upon an analysis of disbursements, substantial questions existed as to the propriety of certain of these disbursements. Accordingly, we felt that Mr. Bentley had to account for approximately $2 million in moneys that did not appear to be properly spent and with respect to Mr. Rose, $500 some-odd thousand dollars. As a result, I instituted certain proceedings in the U.S. District Court for the Southern District of Florida in November 1983 and hearings were held on these proceedings in November and December of last year.

I filed orders to show cause directly against Mr. Rose to show cause why he shouldn't turn over $514,000. I had an order to show cause signed directly against Mr. Bentley to show cause why he shouldn't turn over $2.3 million, and as a footnote, but nevertheless, as an application to the court, we filed an application against a Ms. Ott who we believe is Mr. Bentley's wife to show cause why she shouldn't turn over some $75,000 which appears to be an aggregation of $51,000 that was transferred to her plus another $23,000 which went to another bank in Fort Lauderdale to pay off a personal loan.

In any event, on December 10, District Court Judge Roettger entered an order against Ms. Ott, who did not appear, requiring her to return $75,000, and I invoked a provision under Florida law which deals with conversion pursuant to which you may recover treble damages.

The court also required her to show cause why she shouldn't turn over the three times $75,000.

In addition to that, and I will be candid to say I received a great deal of mail contrary to this, a settlement was reached with Mr. Rose in the sum of $50,000. Mr. Rose agreed to pay back to me $50,000. He has paid back $30,000 and the remainder is due in installments of $5,000 through July 1984. I will return to that in a moment. I just want to round out the status of the proceedings.

With respect to the situation involving Mr. Bentley, that matter is still pending before the court. We have to submit closing arguments and probably prepare for proposed findings of fact and conclusions of law, so there has not been any formal adjudication as to whether or not the allegations in Miami to show cause will ultimately stand up.

A question that has come up is why settle with Mr. Rose and, indeed, it is no secret because I advise the customers of UPMI, why settle with Mr. Bentley, why settle with anybody in this case?

[At this point in the hearing, Senator Chiles withdrew from the hearing room.]

Mr. **Nortman**. The answer is simple and it echoes many of the things we heard this morning and certainly echoes the remarks of Mr. Faircloth. I have a stake which in aggregate is now approximately $100,000, which has been reduced. Part of the reduction came about because Judge Roettger expressed to me on many occasions, "I do not want you to use up more in the salvage operation than is ultimately salvageable." So I followed the court's directive, and last month, I distributed $25,000 to approximately 580 customers. The arithmetic is rather simple. You are talking about a check for $43 and change. Hopefully, this is only an interim distribution, but to be candid, I am not sanguine there will be substantially more, but it comes back to the point I was making, why did we accept anything from Mr. Rose, and it also points to a misperception that many customers have. I do not have the power to institute criminal prosecution. I view my responsibilities as getting as much back into the till, if you will, as I can.

I recognize that $50,000, when you are asking for $500,000, is not a significant percentage. I have to balance that against the probabilities of successfully recovering money. We heard this morning from the State of Florida about offshore corporations being set up. I think that speaks volumes on the difficulty that I would have in spending more money trying to chase down more assets when, in fact, I may get a judgment which will be very decorative but not necessarily very remunerative.

Those factors go into the settlement of any case, and I am sure everybody in this room can appreciate the problem. So we have now the problem of the limited size of the estate in terms of the expenses. I might add that I have not received any fees since April. The accountants are owed a substantial sum of money for the work that they performed. So I have to make some very pragmatic judgments and I echo the remarks, that if any money is ever going to shake loose, it is only going to be with respect to incarceration situations.

Finally, I would say they definitely did not confine their activities to any one particular geographical area. They operated basically in every State of the union, except Hawaii.

I might add, Senator, there were at least two customers I could identify from the list from New Hampshire. California was No. 1 with approximately 90 customers. Texas was No. 2 with 51. Ohio was No. 3 with 49. Florida was next ranked with 38, followed by New York with 34, and Michigan with 24.

In short, the receivers lot is not a happy one, but I hope the information I have stated today and my attachments and letter will be of some help to this subcommittee and I thank you for the opportunity to assist.

[The letter and attachments referred to was marked "Exhibit No. 5," for reference. The attachments may be found in the files of the subcommittee. The letter referred to dated March 9, 1984, from William Nortman to Senator Rudman, follows:]

EXHIBIT NO. 5

GUREN, MERRITT, UDELL, SOGG & COHEN,
Miami, Fla., March 9, 1984.

Re Universal Precious Metals, Inc. ("UPMI").

Senator WARREN B. RUDMAN,
Committee on Governmental Affairs, Senate Permanent Subcommittee on Investigations, Washington, D.C.

DEAR SENATOR RUDMAN: This is in reply to your letter of February 29, 1984 and certain conversations recently had with Ms. Fox, Staff Counsel in which you requested a prepared written statement prior to March 16, 1984. In light of the request that written materials be expeditiously submitted, I have taken the liberty of enclosing herewith reports that the undersigned has filed with the Court dated April 19, 1983, June 1, 1983, July 1, 1983 and October 31, 1983 as well [illegible] copy of a recent letter that I have transmitted to customers of Universal Precious Metals, Inc. in connection with making an interim distribution. Also attached is a "compilation report" prepared by the Receiver's accountants which summarizes the cash receipts and disbursements of the estate for the period December 10, 1982 through October 8, 1983.

I believe that the information contained in these reports and most particularly the reports dated October 21 and 31, 1983, which were prepared by the national accounting firm of Oppenheim, Appel, Dixon & Co., discusses, in some detail, the matters that you referred to in your letter. Accordingly, rather than repeat all that is contained in these reports I will refer you to them and attempt to respond to certain of the items you have raised in your letter which may not have been addressed in the enclosed reports.

DISCUSSION

Approximately 580 active customer accounts were found at the time the Receivership was instituted in December, 1982, and based upon the analysis prepared by the accountants, as more fully specified in the October 31, 1983 report and the report of the Receiver dated July 1, 1983 it appears, as stated on page 8 of the accountants' report: ". . . that the amounts due customers, based on the excess of cash paid and commodities delivered to UPMI over cash paid and commodities delivered to customers, for those customers who had open positions and did not received [sic] their 'Remits Due', is approximately $5,800,000."

To date, the Receivership has recovered approximately $133,000. These sums were derived from certain bank and brokerage accounts and the liquidation of properties on the premises of UPMI and/or that were seized by the Federal Bureau of Investigation and turned over to the Receiver. In addition, the Receiver has received $30,000 from a principal of UPMI, Mr. Jack Rose, in payment of a settlement which was agreed to. The settlement is in the total sum of $50,000 and it is anticipated that the balance will be paid by July, 1984.

As is typical of Receiverships that arise in the context of a fraud case brought by agencies such as the Commodity Futures Trading Commission, marshalling assets is a difficult assignment. The problem was aptly summed up by Receiver Edward Dangel who was a court appointed Receiver for CPI & Bartx Petroleum: "In the particular receiverships that I am involved with, most of the money, almost all of it, had disappeared by the time the Receiver was appointed and, therefore, a good deal of my efforts has been involved in obtaining the necessary funding in order to chase people as far as Panama." [1]

As more particularized in the reports submitted herewith, the books and records that were found on the premises of UPMI were woefully inadequate to reconstruct the financial condition of the firm. The major thrust with respect to marshalling assets has been, in addition to liquidating assets and property that were discovered, instituting legal action against the principals of UPMI and others. In this regard on November 17, 1983 the Receiver filed certain Orders To Show Cause against the principals of UPMI, Mr. Jack Rose and Mr. David Bentley as well as a Ms. Willa Ott who is the wife of Mr. Bentley. These Orders to Show Cause, which were based upon the information compiled by the accountants and the report submitted October 31, 1983, required the above named persons to show cause why judgments should not be entered requiring them to turn over $514,148.00, $2,301,935.00, and

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[1] Remarks of Edward Dangel, hearings before the Permanent Subcommitte on Investigations of the Committee on Governmental Affairs, United States Senate, 97th Congress (Feb. 23-25, 1982) at page 85.

$75,409.28, respectively. As noted above, Mr. Rose entered into a settlement with the Receiver after review by the Commodity Futures Trading Commission and approved by the Court in the sum of $50,000.00. The matter is still *sub judice* as to Mr. Bentley. On January 10, 1984 the Court, upon consideration of the record and the failure of Ms. Ott to appear, entered an Order requiring Ms. Ott to turn over approximately $75,000.00 to the Receiver. This Order was based upon unanswered charges that monies appeared to have been improperly misappropriated from UPMI for Ms. Ott's personal benefit. In addition, pursuant to a Florida statute which creates a civil penalty for conversion, the Court trebled the amount that Ms. Ott is required to turn over. The Receiver is currently taking steps to execute upon this judgment although a Notice of Appeal has been filed.

With respect to distributions to customers, it should be noted that from the very inception of this Receivership, the Court has been most concerned that "more money is not spent in the salvage operation than is ultimately salvagable". So as to assure that some distribution has been made, the Court required the Receiver to distribute $25,000.00 to the approximate 580 investors. This was recently accomplished and the letter transmitting a check in the approximate amount of $43.00 to each customer of UPMI is annexed hereto. It is hoped that this will only be an interim distribution and that more monies will forthcoming as Mr. Rose continues to fund the settlement agreement and the litigation instituted by the Receiver results in a recovery. However, there can be no assurance that even if favorable judgments are entered that this will necessarily result in the recovery of funds in that investigation caused to be conducted by the Receiver indicates that certain of the properties that the principals of UPMI may have owned were transferred to offshore companies in the Turks and Cacos Islands. Indeed because of the problematical nature of successfully recovering on any judgment, the Receiver has under consideration a settlement proposal proffered by Mr. Bentley.

The following administrative costs have been incurred in connection with the administration of the estate through October 8, 1983: Legal fees, $3,611; Accounting fees, $28,000; Receiver's fees, $17,186.

There is also pending several fee applications made on behalf of the Receiver, counsel and the accountants. These fee applications have been pending since approximately April, 1983.

With respect to the states represented by the customers of UPMI, a review of the customer list reveals that there were customers in virtually every state of the Union, except Hawaii, as well as customers in the District of Columbia and Puerto Rico. The heaviest concentration of customers were in California, Texas, Ohio, New York, Florida and Michigan.

It is hoped that the information contained herein and in the attached material will be of some assistance to you and your committee members in connection with its ongoing investigation.

Sincerely,

William Nortman,
Receiver for Universal Precious Metals, Inc.

Senator **Rudman**. Mr. Nortman, we thank you very much for that very complete testimony. I just want to make an observation that the subcommittee is very impressed with the caliber of people that the State of Florida appoints as receivers and trustees.

Mr. **Nortman**. Thank you.

Senator **Rudman**. You both certainly have made very excellent presentations. At this point, I would like to make a brief statement for the record with respect to certain transactions involving the owners of Universal Precious Metals, David Bentley and Jack Rose.

Public information gained by subcommittee shows that both Bentley and Rose made significant and substantial transfers of real estate holdings to offshore companies formed in Turks and Caicos Islands in 1982. In fact, the Fort Lauderdale News, January 30, 1984, reported that Bentley transferred over $900,000 in property to an offshore company and that Rose transferred over $440,000 in property to a separate offshore corporation. The Permanent Subcommittee on Investigations corroborated these transfers from independent sources within the United States and in the Turks and

Caicos Islands. And we will, after certain editing for reasons of security, enter into the record of this hearing a communication we have from the attorney general in Grand Turk, Caicos Islands, Mr. D. C. Lang.

[The correspondence referred to was marked as "Exhibit No. 6," for reference, and is retained in the confidential files of the subcommittee.]

Senator RUDMAN. It is safe to say that normally such transfers would not raise questions, but the subcommittee has learned enough of the illegal use of offshore corporations in previous hearings and other subjects to suspect that these are not normal property transfers.

In the first place, the attorney for Bentley and Rose, one David McKenzie, is the U.S. representative for both these offshore corporations. Second, both corporations were set up on the same day that the properties were transferred. In addition, the property transfers include the personal residences of both Bentley and Rose and both Bentley and Rose continue to reside in these allegedly transferred properties.

Finally, we have found that both these corporations are identical in virtually all respects except that they have distinct names. Bentley transferred his property to Springbourne, Ltd.—a nice ring to it—with the address of The Fortress, Pond Street, Grand Turk. Its registered representative in Grand Turk is International Corporate and Legal Services, Ltd., trading as INCOLEX. INCOLEX is beneficially owned by Seymour Gorman and P. T. N. Donegan. Gorman owns one share of Springbourne and INCOLEX owns two shares.

Rose transferred his property to Island Land Development & Leasing, Inc., again a Turks and Caicos company with the same address as Springbourne. Island Land has authorized capital of $5,000, the same as Springbourne, and has only one share outstanding, that owned by P. T. N. Donegan. The registered representative for Island Land is the same for Springbourne, that is INCOLEX. Gorman and Donegan are directors of INCOLEX. Donegan practices law in the Turks, and Gorman is a solicitor of the Supreme Court in England.

Our experience with the questionable, if not illegal, use of offshore corporations leads us to believe that this is a typical ploy by Bentley and Rose to do what is euphemistically called sheltering their assets from U.S. authorities. Both can now claim they no longer own the assets and only rent them from a Turks and Caicos company of which they will no doubt say they know nothing. I think it is fair to assume that if one could go behind these transactions, one would find that, in fact, Bentley and Rose have total control over both offshore corporations through their so-called representatives in the Turks and Caicos. This only emphasizes in very vivid form something this subcommittee has been trying to get at in the other hearings, that is, the whole question of secrecy that exists in these bank laws between our jurisdiction and others. It frustrates the efforts of U.S. law enforcement authorities, and, I think, more importantly, in some cases may, and I stress may, keep very important assets out of the hands of people like Mr. Faircloth and Mr. Nortman, who are trying to get restitution for people who were defrauded.

I believe this subcommittee will continue in this inquiry in the coming years and we, of course, continue to work with U.S. authorities, particularly in the State Department, to see if there are some ways to negotiate better agreements than the ones we have.

Let me again thank both of you for being here today. We certainly appreciate it.

Our last panel is Carlos Juenke, chief, U.S. Probation Officer; Richard Miklic, supervising U.S. Probation Officer, Martin Carroll, U.S. Probation Officer, U.S. Probation Office, Miami, Fla.

If you would like to simply raise your right hands, and we will administer the oath. Do you swear the testimony you are about to give in the course of this hearing will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Juenke**. I do.

Mr. **Miklic**. I do.

Mr. **Carroll**. I do.

Senator **Rudman**. You may be seated. I hope I pronounced Mr. Juenke's name correctly.

TESTIMONY OF CARLOS JUENKE, CHIEF U.S. PROBATION OFFICER; RICHARD MIKLIC, SUPERVISING U.S. PROBATION OFFICER; AND MARTIN CARROLL, U.S. PROBATION OFFICER, U.S. PROBATION OFFICE, MIAMI, FLA.

Mr. **Juenke**. I am Carlos Juenke, Chief U.S. Probation Officer, southern district of Florida. With me are Richard Miklic, supervisor of our special offender unit and Martin Carroll, an officer in that unit.

As a background to our remarks, collectively we have some 35 years of experience in probation and parole work. We sat and listened this morning with frustration and outrage to the testimony of your expert witnesses, the hopelessness of the victims. As probation officers, we work with the end product of the criminal justice system. All that goes before us—investigation, prosecution—has the purpose of deterring crime, punishing and rehabilitating the criminal, and restituting the victim.

Once a prosecutor has his conviction, the defense counsel his fee, the criminal his sentence, the ends of justice should have been served. That is usually true, but with this criminal that is the subject of these hearings, that is a myth. Instead of justice, instead of punishment, instead of deterrence, instead of compensation to victims, this criminal has frequently merely been inconvenienced. Because of the nature of his crime and its penalty and how the system deals with this criminal, seldom does the penalty fit the crime. Seldom is there deterrence and seldom is the victim compensated. Most assuredly, seldom is this criminal rehabilitated.

Close the loopholes, increase the investigation and prosecution of these frauds and all that you may be doing is perpetuating the myth that justice has been served.

Mr. Miklic and Mr. Carroll will give you some real life examples of this myth in action in the criminal justice system. Richard.

Mr. **Miklic**. Thank you. I would like to summarize my prepared statement.

Senator RUDMAN. We would like you to do that, and we will incorporate your entire statement in the record.[1] Thank you very much for that very good introduction of your two agents.

Mr. MIKLIC. We as probation officers, as Mr. Juenke said, have a different slant on the problem than some of the other witnesses because we deal with these investment swindlers after conviction. We prepare and present reports which help the courts in imposing sentence on them. Most eventually come out on probation or parole for periods, of 3 to 5 years, and we are charged with supervising them during those periods of time.

Unfortunately, our experience has been the same as that of some of the other witnesses here this morning, that successful prosecutions and convictions often do very little to solve the problem. We see two reasons for this.

First of all, very frequently these offenders are given lenient sentences. They rarely go to jail for substantial periods of time, and if they are placed on probation, as they usually are, it is generally with no real restrictions or controls on their activities.

We also observe firsthand the failures of the various remedies like court ordered restitution or civil law suits, and so forth, which are designed to help the victims get their money back.

I would like to just discuss a few examples from our caseload to show what these kinds of people do after conviction frequently: To show how brazen and persistent they are in continuing their frauds, how little they are deterred by the kind of sentences many of them get and how contemptuous they are of their victims, how little regard they have for them.

The first example is a case of Mr. Carroll's who was convicted of investment fraud in 1981. He was convicted and sentencing was deferred for about 30 days so our office could prepare a presentence report to help the court decide on an appropriate sentence. This offender made a written statement to the court in which he expressed deep remorse for the crime and assured the court he had gone into a new business, a strictly legitimate one. It was only several years later we found out that during the same period this man was making representations to the court and begging for leniency, he was using this brand new company to defraud additional investors of over $31,000. He was sentenced to a brief term of imprisonment followed by probation with a special condition to make restitution. He served his time and came out on probation. However, he now claims he is too poor to make any substantial restitution payments and is really only making a token effort.

While he was on probation, he was convicted for the second fraud which he had committed in 1981. Despite his reported poverty, he signed an agreement with the victims of that second fraud promising to give them a substantial down payment and follow this up with regular restitution payments.

Based on this contract, the victims actually appeared at his sentencing hearing on the second case and spoke on his behalf. However, as soon as the sentencing was over, he reneged on the contract and they were paid nothing. We are currently trying to have his probation revoked.

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[1] See p. 138 for the prepared statement of Richard F. Miklic.

Another even more brazen example involves a case of mine who went out and committed a new investment fraud while he was supposed to be in prison. This man was given a brief period of confinement, again, to be followed by probation. He managed to convince prison authorities to place him in a halfway house rather than in a jail or prison-type facility. We have very strong evidence he spent no more than 2 days at this facility. He apparently conspired with the woman in charge of the facility, who allowed him just to leave. He apparently conspired with her also to forge documents and make it appear to the prison authorities that he was actually there.

We did conclusively prove at a recent probation revocation hearing that on two occasions this man traveled from Fort Lauderdale out to Los Angeles, Calif., without any kind of proper authorization. This legally constitutes an escape; and what this escaped Federal prisoner was doing out in Los Angeles was defrauding an investor in connection with a multimillion-dollar tax shelter commodity fraud.

During the same period of time when he was supposed to be in prison, this man was appearing before a civil court which was trying to collect $565,000 in money which he admitted bilking from other investors. He made representations to the court that he was unable to pay any of this money because he was confined, because he had been convicted, and because he was unable to earn a living.

Mr. Carroll also has another case currently on probation for a boilerroom commodity fraud of the type you are looking at. When he came on probation, he told Mr. Carroll he was operating a maid service. When Mr. Carroll and I made an unannounced visit to his place of employment, we walked in and found a typical boilerroom operation in full swing, with a large staff of salesmen selling gold over the telephone. This man was in the rear in a large office, obviously in control of the operation, but he brazenly insisted he was simply sharing space there. Mr. Carroll promptly ordered the man to get out of the office space and have nothing further to do with the boilerroom operation. His response was that he would comply but he complained that Mr. Carroll was deterring him from making a living. He said he was going to stop making the court-ordered restitution payments because he could no longer afford to make them.

This man was supposedly broke, although at the time of sentencing, he was living in a house overlooking the ocean. I am sure somewhere down the road this man will sue us for violating his constitutional rights.

These type of tactics are common with these offenders. As a final example of what the victims are up against, I would like to talk about a man I have on probation for a multimillion dollar coal fraud. He was given a short term of confinement followed by probation. There was no special condition that he make restitution. However, he is being sued by some of his victims. This man lives in a house which is worth approximately $1 million. He has the use of several expensive automobiles, including a DeLorean sports car which he usually drives, he wears an expensive Rolex watch, his children are in expensive private schools, and so on. However, his victims don't stand a chance to collect a dime from this man even if they should win their suit because like most other swindlers, he is judgment proof.

After this man was convicted, he decided he would not want his family to suffer for his mistake, so he agreed to a divorce from his wife. He also agreed to a property settlement whereby she received all the family assets. Now when he went to prison and began serving this brief confinement term he had, he conveniently forgot to tell prison officials about the divorce. The reason was he wanted to get a furlough to go home for a couple of weeks to comfort his wife. He got a statement from his psychiatrist saying his wife needed him at home. He was able to return home within a month of arriving at the Federal facility. He would not have been able to receive such a privilege if it had been known he was divorced.

As soon as he was released, beginning his probation sentence, he immediately reunited with his former wife and they remarried a short time later. Still, he did not want his family to suffer with his mistakes so he signed a prenuptial agreement renouncing any family assets.

We have information from solid sources this man has substantial sums of currency that is concealed in offshore bank accounts.

[At this point in the hearing, Senator Chiles entered the hearing room.]

Mr. **Miklic**. These are the kinds of experiences we have with some of these people. Our belief is that the only kind of sentence that is going to have any impact on these people and deter them from committing these kinds of crimes is substantial confinement sentences. I am not talking 2 years, 3 years, but 10 years, 15 years, the kinds of sentences the major narcotic traffickers get.

We also believe that probation can have a useful function, not simply as a replacement for confinement, but in addition to confinement. If a man is sent away for a substantial period of time for deterrence and when he comes out he is placed on probation for a long time, probation that will actually control his activities and protect society, then perhaps we can do something to really protect society. That kind of probation should include, very simply, a special condition that he is prohibited from any kind of employment involving investments. He should be required to submit to regular audits of his finances. He should, of course, be required to make restitution to his victims. If he doesn't follow through on these conditions, the court should back up the probation officer and send this man back to jail for another substantial period of time.

We think these are the kinds of techniques that are needed to bring these people under control. Otherwise, prosecution and conviction frequently is just an exercise in futility.

We hope that by sharing some of our experiences here with you today we can focus attention on this and encourage probation officers, prosecutors, and other people dealing with the post conviction, sentencing process to take these people more seriously.

Senator **Rudman**. Thank you very much. I think we will hear from the other panelists and then have questions.

Senator **Chiles**. Mr. Chairman, I am going to have to leave in a minute. I wonder if I can ask a question?

Senator **Rudman**. Sure.

Senator CHILES. My understanding is some of these people you are supervising weren't necessarily convicted in Florida?

Mr. JUENKE. The majority are not.

Mr. MIKLIC. Most are not.

Senator CHILES. How is it Florida seems to be just a favorable place for probation? Is that something you fellows are looking forward to getting under your care or something else that is attracting them?

Mr. JUENKE. That is the very least thing attracting them. We established a year ago a special offender unit. What we are doing, as the Florida Comptroller's Office spoke earlier, is driving them to California and back up North. I think it is the climate, so many of their friends who are like them live in southern Florida and attract them to that part of the country.

Senator CHILES. It sounds like they are still interested in pursuing some of their activities.

Mr. JUENKE. Oh, yes.

Senator RUDMAN. You know, I say to my friend from Florida, with all the wonderful ads I see on television every night about the wonders of Florida in the wintertime, I can understand how it attracts all kinds of people.

Senator CHILES. The sun shines on the good and evil alike as the rain falls. We would like to spread some of these evenly across the land as well. Thank you, Mr. Chairman.

Senator RUDMAN. I understand that Mr. Carroll does not have a statement but will answer questions.

[At this point in the hearing, Senator Chiles withdrew from the hearing room.]

Senator RUDMAN. I have just a couple of questions. We will hear from the Justice Department later in these hearings. It seems that the U.S. Attorney's offices don't have enough manpower for all the things they are trying to do. Prosecutors generally tend to forget about cases after the jury has come in with a verdict. Would it be helpful to you to have a continuing relationship with the U.S. attorneys who have prosecuted these cases? They will recognize that much of their effort is going for naught. What about judges—don't some of the judges down there get a little bit concerned about how their orders are being flaunted?

Mr. MIKLIC. Again, Senator, as we pointed out, most of the cases we are talking about are sentenced in other jurisdictions, so our judges don't have jurisdiction over a good number of these people.

As far as U.S. attorneys' offices are concerned, we agree strongly we need some kind of liaison with them to help pursue revocation proceedings against these people when they do violate their conditions.

Mr. JUENKE. One of the problems that occurs is the prosecutor who prosecuted the cases might not be the defense attorney when we finally revoke the defendant.

Senator RUDMAN. Hopefully not in the same case.

Mr. JUENKE. Hopefully.

Senator RUDMAN. Let me ask you this. If you have the kind of violation that you have been describing as a matter of course, is notification sent to the sentencing judge automatically?

Mr. CARROLL. As a matter of course, we do advise the courts what is going on with the case any time there is a violation situation. The big problem there is some of the situations we described where the lifestyle hasn't changed, where there are assets but we can't prove there are assets. Even in a probation violation proceeding, you have to prove the man's ability to make restitution in order to violate. That is our big problem. We know his lifestyle, we strongly suspect the assets have been transferred, yet we can't prove he has the ability to pay.

Senator RUDMAN. In the case of the gentleman who was back in business before he was even sentenced, the case of the individual who conveniently got a divorce for obviously fraudulent reasons and then committed fraud upon the prison officials by furnishing a psychiatrist's letter, isn't that the kind of thing most judges would take a rather dim view of and essentially increase the sentence?

Mr. CARROLL. I think I can answer the divorce part because I have heard that excuse. It was the trauma, the whole Government against me, my wife couldn't take it anymore, but once everybody is settled, we realized we loved each other and we are back together—how do you prove that is not true?

Senator RUDMAN. It wouldn't be hard to prove to me, but I am not a Federal judge. It seems to me, as I listen to your testimony, what you are saying, and we hear this from other witnesses, is that we have a case of recidivism here that is probably up in the high 90's. There are very few of these people who are being sentenced for their crimes, serving time, and then returning to society.

Mr. MIKLIC. It is not a question of returning to crime, most of them don't stop. They continue while they are on bond, while on presentence investigation, when they are sentenced to jail. It is people not taking this crime as seriously as they would a major drug trafficker, as they would an organized crime figure.

Senator RUDMAN. I don't know just how you deal with that, with the diversity of judges around the country. I know a number years ago, when I was attorney general in my State, I came under severe criticism for stating in certain sexual offenders' cases, it seems to me that what we ought to do is lock them up and throw away the key. That is a harsh statement. In that case, it certainly was true. In the case you are talking about, I guess you are not saying quite that, but you are suggesting that the key be put where it is hard to find for a good long period of time.

I am not sure what that achieves except it gets the violators out of circulation for a longer period of time, which will probably save consumers in this country millions and millions of dollars.

Mr. MIKLIC. I think it would deter them, too, if they know they are facing, as opposed to 4 months, 6 months in jail, they are facing several years.

Senator RUDMAN. We thank you very much for appearing before the subcommittee. Before we recess the hearing today, we are going to enter into the record a staff statement[1] prepared for the hearings and a copy of the salesman's prepared pitches or script which the staff has obtained.

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[1] See p. 145 for the subcommittee's staff prepared statement.

[The material referred to was marked "Exhibit No. 7" for reference, and follow:]

EXHIBIT NO. 7

FOR TRAINING PURPOSES ONLY

This is ———————————. I'm an account executive with Brown, Bradford & Ryan Investment Corporation. How are you today?

I know you are interested in investments. I have an investment that is yielding as much as 40 to 100% return. We are a national marketing firm in the business of raising capital for gold mines that are expanding their operations. Our function is similar to that of the underwriter who raises money by issuing stocks and bonds.

The difference is that you are investing in gold ore: this ore is extremely valuable. It's not like an investment in Krugerrands, or gold stocks, or commodities, or anything that requires a margin call. This is ore from a mine that has proven commercially valuable.

Are you familiar with the gold market?

Now, ———, the total investment for each unit is $6,750. That controls 250 tons of ore, which will be processed in 12 months or less. The assay report which I will send you is very high in gold!!!. The potential profit is up to 100% and the risk is minimal. We even offer specific warranties associated with this program.

Gold right now is ———. And most precious metal experts feel that gold will be at 600 to 1,000 in the next 12 to 18 months. The Aden sisters, who have been absolutely correct on every gold in the last 10 years are predicting 4,000 gold by 1985. Isn't that amazing? Where do you feel gold will be next year?

One other great feature of this investment is that you can take the proceeds in bullion form—and since you have the same advantages as the miner, you don't have to pay taxes until you sell it since the I.R.S. considers it your inventory. What that means to you, is that you take your profits in 10 or 20 or 50 ounce bars of gold or if you want cash. Isn't that great?

Now can you understand why the units get sold so quickly?

Now, if you're in a position to participate in one or more units, I'll send you all of the written data, but you have to remember that this is a limited offering which is subject to price change.

These final questions will see if you qualify for this investment:

1. Do you have 7 to 14,000 dollars to invest for one or two units about a week from now?
2. Do you make your own investment decisions?
3. Have you ever invested in gold?
4. If yes—coins, stocks or commodities?
5. Do you follow the gold market?
6. Do you think gold will be higher, lower or the same next year? If higher or the same, continue. If lower—this investment is apparently not for you, goodby.
7. What other investments do you have?
8. What kind of work do you do?
9. What is the best time of day to get back with you and explain the program?
10. You must be willing to spend at least 15 to 20 minutes with me next week, so you can understand the program thoroughly, it's very unique. Are you willing to spend the time to go over the program with me?
11. (a) A year from today, after you have made 100% on your investment would you be willing to reinvest in other mines that we will be raising capital for?

(b) And would you refer your business associates and friends as well?

12. If the program is as good as I've outlined, are you prepared to move on this immediately?

Congratulations ———, from what you have told me, you qualify as the right type of client we'd like to do business with. Right now I'm giving my clients a processing date of Oct. '84 and I will reserve this date for you for one week for two piles. Of course you're under no obligations, but you are protected until you receive the information. Once you understand the program you're going to say it's too good to be true. However, when I get back with you and go over it, you'll understand that it is for real.

13. Where will the papers be when we get together on the phone?

Let me check your name and address. (If only one phone No. get the other). I'll call you next week and we'll go over the program thoroughly together. Once you understand it you'll be anxious to get started immediately.

Hello Mr. ———. My name is ——— with the Wellington Company. The reason I'm calling is to comfirm that information will be going out to you, at no charge, introducing you to the profits being made in the precious metals market. And your timing couldn't be better! As I'm sure you've been reading, the analysts feel that the precious metals market—and particularly silver—will be making a major move!

Mr. ——— the Wellington Company as precious metals dealers, give clients like yourself the opportunity to position themselves in the metals market at todays price, to take advantage of the coming advances in silver! Mr. ——— with an investment of $6,000 you will control 3,000 ounces of silver, at todays price, for one year with no downside risk! And Mr. ——— some analysts feel that silver prices will reach $150-$200 per ounce. But seriously speaking, if the price of silver only goes to $30 per ounce, you are looking at a return of $60,000!! Now Mr. ——— if I can show you how to safely turn $6,000 into a $60,000 return, are you in a position where you can handle a $6,000 investment? (If yes, fine—if no—I can understand that.)

Mr. ——— we are talking about a precious metals investment and its not for everyone. Let me ask you a few questions to see if we can get together.

By the way my first name is ———. What do your friends call you? I wouldn't be forward by calling you by your first name would I? (On first name, friendly, basis get the answers to these questions.)

1. What do you do for a living?
2. What's your age?
3. Are you married or single?
4. Are you investing in stocks, bonds, or commodities? (How much—very impersonal!)
5. Are you using lower yielding investments such as treasury bills, certificates of deposit or money market funds? (again, ask how much.)
6. How much do you have working in savings and checking?
7. Do you use hard currencies such as gold or silver?
8. Do you keep money in mutual funds or credit unions?

(First name), I'm going to send our brochure out to you. What address would you like it sent to? (get address—do not tell him his address—make him tell). You will probably have the information in a few days. Now, if everything I'm sending you is on target and meets your approval, you are seriously interested in making this type of money, right? (Get a strong response!) I'll be in touch with you in a few days to answer all of your questions. Jot down my name and toll free number.

Hello Mr. ———. This is ——— from the Wellington Company. Glad I was able to reach you. I have some exciting news! We had a meeting this morning, our banking sources tell us that for the past week there has been a tremendous increase in new orders for physical silver and our advisors are telling us to get as many clients into the market as possible! Get a piece of paper and a pen, bring them to the phone, and let me show you what this will mean to you financially. I'll hold on. (Shut up.) (When he returns:) Let me explain our program: The Wellington Company as precious metals dealers, give clients like yourself the opportunity to position themselves in the market at today's price to take advantage of the advance in silver. With a relatively small investment you will control silver at today's price for one year with no downside risk! Now as I mentioned, due to the increased buying in physical silver, our advisors are telling us to get as many clients into the market as possible, and I'm sure you'll agree the key to success in any investment is timing, and right now your timing couldn't be better! Now write this down!

1. 3000 ounces.
2. Multiply by $10 per ounce (Avg silver price) plus 5% Brokerage Fee, Storing, Insurance, Delivery).
3. Equals $30,000 in silver being controlled.

Now, ——————— your total investment is $6,000.

4. $3,000 represents a 10% deposit, locking in silver at today's price for one year.
5. Now, ——————— 3,000 ounces at a projected price of $30 per ounce equals $90,000 or a $60,000 return on a $6,000 investment—not a bad return, right?

As I said before your timing couldn't be better. The market is ready to explode and we only have a few positions available, at $6,000 per position. How many can you handle? One or two? (shut up).

Overcome objections, isolate the objection, is that all that is holding you back?

Now what I have to do ——— is go down to our allocations department and lock up —oz. Positions for you. What I will need is your social security. What is that? (shut up) (again, any objections, isolate and cash). Hold on, I'll be right back. Congratulations, we got the positions. (Go for mailgram, 1—bank wire, 2—check.)

Senator **Rudman**. We will continue these hearings with further witnesses at 9:30 in the morning on Wednesday, the 21st, in this hearing room, and we thank you all.

The subcommittee will stand in recess.

[Whereupon, at 12:28 p.m., the subcommittee recessed to reconvene at 9:40 a.m., Wednesday, March 21, 1984.]

COMMODITY INVESTMENT FRAUD II

WEDNESDAY, MARCH 21, 1984

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 9:40 a.m., in room SD-342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. Warren B. Rudman (vice chairman) presiding.

Members of the subcommittee present: Senator Warren B. Rudman, Republican, New Hampshire; Senator Sam Nunn, Democrat, Georgia; and Senator Lawton Chiles, Democrat, Florida.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; James B. McMahon, deputy chief counsel; Chuck Morley, chief investigator; Katherine Bidden, chief clerk; Carol Fox and Dan Mastromarco, staff counsel; John Sopko, assistant counsel to the minority; Leonard Willis, minority staff investigator; Dan Kalinger, press secretary; Vance Belcher, investigator for the majority; Sarah Presgrave, executive assistant to the chief counsel of the majority; Carla Dooley and Cindy Comstock, staff assistants.

[Senator present at the opening of the hearing: Senator Rudman.]

Senator RUDMAN. The Permanent Subcommittee on Investigations will be in order.

[Letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the Chairman, or any Member of the Subcommittee as designated by the Chairman, to conduct open and/or executive session hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Commodity Investment Fraud II, to be held on March 19 and 21, 1984.

WILLIAM V. ROTH, Jr.,
Chairman.

SAM NUNN,
Ranking Minority Member.

OPENING STATEMENT OF SENATOR RUDMAN

Senator RUDMAN. We will continue our hearings this morning. Let me just announce that due to a very serious conflict in scheduling, we are going to have to split these hearings today. The President has asked that all Republican Members of the Senate meet with him in the Capitol at 11 o'clock this morning. So what we are going to do is proceed with our first witness, Mrs. Saxon, and then I believe it is our intention—the chief counsel can correct me if I am incorrect—that we will proceed out of order and we will hear from Stanley Marcus, the U.S. attorney from Miami, Fla., and attempt to conclude those two witnesses by approximately 10 minutes of 11 or quarter of 11. So we will try to keep the testimony of the first two witnesses relatively brief.

Thereafter, we will reconvene at 3 o'clock this afternoon and then proceed with the other witnesses.

I apologize for any inconvenience that that may cause any of the witnesses, but obviously it is something that doesn't happen terribly often. We don't really have too much choice.

With that, I will ask the first witness and her attorney if they will come forward, Mrs. Saxon.

Mrs. Saxon, before you are seated, I am sure you are aware that we have a rule here which requires that you take the oath. That is a rule of the Permanent Subcommittee on Investigations, so we will administer the oath to you. If you would please raise your right hand.

Do you swear the testimony you are about to give in the course of this hearing shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mrs. SAXON. Yes, I do.

Senator RUDMAN. Fine. You may be seated.

TESTIMONY OF SUSAN SAXON, FORMER EMPLOYEE, BULLION RESERVE OF NORTH AMERICA, LOS ANGELES, CALIF., ACCOMPANIED BY A. HOWARD MATZ, ESQ., LAW FIRM OF NUTTER, BIRD, MARELLA, BOXER, WOLPERT & MATZ

Senator RUDMAN. Mrs. Saxon, if you will pull that microphone up fairly close to you, you will find it is probably going to be a lot easier.

You may like to identify your counsel, or he may introduce himself.

Mr. MATZ. Good morning, Senator. My name is Howard Matz, M-a-t-z. I am counsel, as you noticed for Mrs. Saxon.

Senator RUDMAN. Will you identify the law firm you are associated with?

Mr. MATZ. Yes. It is Nutter, Bird, Marella, Boxer, Wolpert, & Matz.

Senator RUDMAN. Located where?

Mr. MATZ. Beverly Hills, Calif.

Senator RUDMAN. We appreciate your being here this morning. Mrs. Saxon, you are here in response to a subpena which you allowed us to serve on your counsel. Is that correct?

Mrs. SAXON. Yes.

Senator Rudman. The subcommittee feels that it is very important to shed as much light as we can on how businesses such as Bullion Reserve are run because there are many similar to it still operating in the country.

We heard testimony on Monday regarding Florida operations. I think we need more information about California. We have a number of questions today which we believe will be of great assistance to the subcommittee in determining whether legislation is necessary in this area. We appreciate your cooperation.

I want to assure you that we are here only to get information as you can furnish it to us. We are not interested in some of the collateral issues that have been raised in the press: personal issues. We are going to go over some testimony that in many ways tracks testimony that you have given in other places at other times. So we will proceed then, and to the extent you wish to consult with the counsel, you certainly may do so at any time. Under the rules of the subcommittee, Mr. Matz, the counsel is certainly allowed to consult freely with your client, but you are not allowed to testify, unless at some point you think it is necessary that you do testify, in which case we would be happy to adminster the oath to you. But I think that would be rather unusual.

So we will start off by asking you just a little history, Mrs. Saxon. We want to learn how Bullion Reserve was set up. I understand that your former husband, now deceased, bought the company from someone and then expanded it greatly. Could you tell us when he acquired the company, how much he paid for it, and what its size was originally?

Mrs. Saxon. Yes. He bought the company—he bought controlling interest in the company in September 1981. It was not actually a working company at that time. It was merely incorporated and had shareholders. But there were not any customers. It was not operating.

He was given shares of the corporation in return for direct marketing work which he did for the principal shareholder of the company. This was in the summer of 1981. In September 1981, he then bought controlling interest of the stock, about 51 percent, for $35,000, along with his partner.

Senator Rudman. From whom did he buy that?

Mrs. Saxon. Franz Bader.

Senator Rudman. Who?

Mrs. Saxon. Franz Bader.

Senator Rudman. What sort of background in trading metals did Alan Saxon have?

Mrs. Saxon. None.

Senator Rudman. He had no background whatsoever?

Mrs. Saxon. None.

Senator Rudman. What had he done prior to that?

Mrs. Saxon. He was in advertising and marketing, mainly direct marketing, mail order.

Senator Rudman. Mail order marketing of what products again?

Mrs. Saxon. Various products: kitchen articles, Christmas spoons, small—he worked at International Silver for a while with their catalog, marketing their silverware.

Senator RUDMAN. You, yourself, worked for Bullion Reserve for a period of time. What period of time did you actually work for the company?

Mrs. SAXON. April 1981. I am sorry, I have to correct the time. It was September 1980 that Alan bought the company.

Senator RUDMAN. September 1980?

Mrs. SAXON. 1980. I said 1981. I began working there in April 1981.

Senator RUDMAN. How long did you work there?

Mrs. SAXON. Until it closed.

Senator RUDMAN. We understand that at some point in time Mr. Saxon began to trade future contracts himself. Is that correct?

Mrs. SAXON. Yes.

Senator RUDMAN. Did he have any expert advice on that or did he do that pretty much on his own?

Mrs. SAXON. Well, he had a broker, but he did it on his own.

Senator RUDMAN. Other than the advice he may have received from a broker, it was essentially his decisions that he acted upon?

Mrs. SAXON. That is correct.

Senator RUDMAN. Whom did he trade with, Mrs. Saxon?

Mrs. SAXON. Well, in the beginning, he traded in Dallas. His broker was Mark Dial. He traded in the beginning with Clayton Brokerage and then Mark moved to Rouse Woodstock. He traded there. And then he traded with Merrill Lynch in Greenwich, Conn. And then he traded with Conti Commodities.

Senator RUDMAN. Do you have any idea of the volume of future contracts Mr. Saxon was trading, how much was involved in terms of money; and what volume of future contracts he was trading on a weekly basis or a monthly basis?

Mrs. SAXON. On a monthly basis?

Mr. MATZ. Senator, it may have varied in different periods of time.

Senator RUDMAN. Could you give us the range, what it might have been in dollars?

Mrs. SAXON. Well, I think the minimum he probably ever traded was $100,000. Maybe up to $1 million.

Senator RUDMAN. From $100,000 up to $1 million?

Mrs. SAXON. Right.

Senator RUDMAN. During what, a 1-month period you are talking about?

Mrs. SAXON. Probably during a week period.

Senator RUDMAN. During a week.

I think if you were to pull the microphone down slightly and closer to you, I think it might be—if you pull it a little closer to your lips, you will find you don't have to speak fairly loud and we can hear you.

Mrs. SAXON. OK.

Senator RUDMAN. Do you know Scott Dial and Mark Dial?

Mrs. SAXON. Yes.

Senator RUDMAN. Can you tell us a little bit about their background and what they do or what they did?

Mrs. SAXON. Mark Dial is a commodities trader. When I first met him, he was, as I said, with Clayton Brokerage, and then with Rouse Woodstock. Then he came to work for North American Commodity Reserve, which was, as I understand it, a subsidiary of Bullion Reserve in Dallas and was a commodity trader there. That is all I know about his career.

Scott Dial had been a commodity trader at Clayton Brokerage and, at the time I met him, he was investing privately and that kind of thing, an investment advisor I believe. Then he came to work at Bullion Reserve in Dallas and headed the Dallas office.

Senator RUDMAN. Are you aware of the fact that Mr. Dial was an advocate of moving money to offshore banks and in fact owned a bank in Montserrat?

Mrs. SAXON. Yes.

Senator RUDMAN. You were aware of that?

Mrs. SAXON. Yes.

Senator RUDMAN. Is it also a fact that Mr. Dial was paid in silver bars by BRNA?

Mrs. SAXON. Yes.

Senator RUDMAN. So he would be compensated from silver?

Mrs. SAXON. Yes.

Senator RUDMAN. As a regular way of being compensated?

Mrs. SAXON. Right.

Senator RUDMAN. Do you have any idea how much he received on a monthly period or a yearly period or what his average earnings were if you were to convert that silver to dollars?

Mr. MATZ. Are we talking about Mr. Mark Dial, sir?

Senator RUDMAN. Scott Dial.

Mrs. SAXON. Alan told me that he received every week, I believe, it was a 100-ounce bar of silver.

Senator RUDMAN. What would that be worth at that time?

Mrs. SAXON. Well, if silver was at $10, that would be $1,000 a week.

Senator RUDMAN. I believe it is correct that your late husband originally met Mr. Scott Dial in London. Is that correct?

Mrs. SAXON. That is correct.

Senator RUDMAN. Was he trading futures in commodities in London at that time?

Mrs. SAXON. Scott Dial?

Senator RUDMAN. Yes.

Mrs. SAXON. I am not—I don't know.

Senator RUDMAN. What can you tell us about the Commodity Trading Division of Bullion Reserve? Were customers told that the company traded future contracts?

Mrs. SAXON. No.

Senator RUDMAN. They were not?

Mrs. SAXON. No.

Senator RUDMAN. What can you tell us about the Commodity Trading Division?

Mrs. SAXON. Well, the Commodity Trading Division was in Dallas as far as I know. If a customer wanted to trade futures, they would be referred to the Dallas office. There was no commodity trading for customers at the Los Angeles office.

Senator RUDMAN. Have you every heard of a Bob Martin?

Mrs. SAXON. I have heard of him, yes.

Senator RUDMAN. Do you know him?

Mrs. SAXON. No.

Senator RUDMAN. I guess the question about Mr. Martin relates to Mr. Saxon's trading through a variety of companies. There was some claim that he was using a Bob Martin at Merrill Lynch but that in fact was a hoax. Do you know if that is true or not?

Mrs. SAXON. I believe it is true.

Senator RUDMAN. That it was a hoax?

Mrs. SAXON. Yes.

Senator RUDMAN. Are you aware of the fact that Mr. Martin or someone calling themselves Mr. Martin, who supposedly worked at Merrill Lynch, was essentially on the telephone with Mr. Saxon, and then Mr. Saxon gave the telephone to the auditor, and Mr. Martin, or whoever was on the phone, alleged that yes, he had $70 million in the account that belonged to the trading company, Bullion Reserve?

Mrs. SAXON. Yes, I heard that. I don't have direct knowledge of that.

Senator RUDMAN. You were not directly involved in observing that or hearing that?

Mrs. SAXON. No.

Senator RUDMAN. From whom did you hear that? Did you hear that from your late husband?

Mrs. SAXON. No. I heard that from two other employees.

Senator RUDMAN. Two other employees of the company?

Mrs. SAXON. Right.

Senator RUDMAN. Who were they?

Mrs. SAXON. Cheryl Emery and Robert McKuen.

Senator RUDMAN. Were they both traders?

Mrs. SAXON. No. Robert McKuen was the comptroller and Cheryl Emery was a vice president.

Senator RUDMAN. From their own personal knowledge they reported that conversation to you?

Mrs. SAXON. Yes, Well, it was two different conversations. Robert reported speaking with Bob Martin and Cheryl reported to me that the auditors told her that they had spoken with a man named Bob Martin.

Senator RUDMAN. We have some BRNA promotional literature which talks about "insurance from Lloyds of London in these days of lawlessness." Was there Lloyds insurance?

Mrs. SAXON. No.

Senator RUDMAN. There was not. There was just a claim that was made in literature which in fact was false?

Mrs. SAXON. Well, there was insurance, but it wasn't Lloyds. The insurance, as I understand it, was insurance that Perpetual Storage carried for losses of anything that was in the vault.

Senator RUDMAN. But if there was nothing in the vault, of course the insurance would not cover that.

Mrs. SAXON. Right.

Senator RUDMAN. But the literature kind of implied that it was with Lloyds and didn't indicate too clearly just exactly what that insurance covered?

Mrs. SAXON. That is correct.

Senator RUDMAN. Mrs. Saxon, there was testimony before the subcommittee on Monday that at least two major accounting firms audited the books of the company several months before its collapse. Is that a fact?

Mrs. SAXON. One accounting firm that I know audited in June 1983 and one audited in June of 1982.

Senator RUDMAN. Could you name those companies for us?

Mrs. SAXON. Yes. Laventhol & Horwath was in June of 1983 and Oppenheim, Apple & Dixon audited in June 1982.

Senator RUDMAN. Can you tell us anything about those audits?

Mrs. SAXON. I can tell you what I have since found out about them. I had no knowldedge of the——

Senator RUDMAN. Why don't you do that.

Mrs. SAXON. In June 1982, Oppenheim, Apple & Dixon did not finish the audit because they found an $11 million shortage, and in——

Senator RUDMAN. When was that?

Mrs. SAXON. June 1982.

Senator RUDMAN. That was how long before the collapse?

Mrs. SAXON. A year and 3 months.

Senator RUDMAN. Who retained them to do the audit?

Mrs. SAXON. David Kagel.

Senator RUDMAN. Who is David Kagel?

Mrs. SAXON. The counsel for the company.

Senator RUDMAN. Counsel for the company?

Mrs. SAXON. Right.

Senator RUDMAN. David Kagel?

Mrs. SAXON. He was also a director of the company at the time.

Senator RUDMAN. He retained this firm to do an audit. They came up with an $11 million shortage.

Mrs. SAXON. Right.

Senator RUDMAN. And they, for some reason, at that point decided not to complete the audit?

Mrs. SAXON. Right. They resigned.

Senator RUDMAN. They resigned?

Mrs. SAXON. Right.

Senator RUDMAN. What action did Mr. Kagel take, do you know?

Mrs. SAXON. He resigned as director of the company.

Senator RUDMAN. There might be some ethical problems here, but for the record, did either Mr. Kagel or the accounting firm report those shortages to any other parties, any regulatory authorities?

Mrs. SAXON. I don't know. Not that I am aware of.

Senator RUDMAN. The answer to that is probably no, I would imagine, because of the timespan.

Mr. MATZ. Senator, may I just have the record reflect that although the agenda for today's hearings indicates that my client formerly was an officer of Bullion Reserve, in fact she never was, and she was physically separated from her former husband throughout almost all of 1983, beginning in February 1983.

Senator RUDMAN. Let's put that on the record. Were you ever an officer of the corporation?

Mrs. SAXON. No.

Senator RUDMAN. You were an employee of the corporation?

Mrs. SAXON. That is correct.

Senator RUDMAN. Can you tell us what your salary was with the corporation?

Mrs. SAXON. At what period of time?

Senator RUDMAN. Pardon?

Mrs. SAXON. At what period of time?

Senator RUDMAN. Let's again take it at the beginning, the middle and the end.

Mrs. SAXON. All right. The beginning was approximately $15,000 a year, then approximately $20,000 and then approximately $30,000 and then at the end $80,000.

Senator RUDMAN. Were there any bonuses in addition to that or other expense payments of any sort that were substantial?

Mrs. SAXON. In 1982, I had a $10,000 bonus.

Senator RUDMAN. We understand that Bullion Reserve advertised on the Sid Barlow Show, an investment talk show on KIEV in Los Angeles. We also understand that Mr. Barlow was paid a commission by Bullion Reserve for every customer it received as a result of Mr. Barlow's personal endorsement of Bullion Reserve. Is that true?

Mrs. SAXON. That is correct.

Senator RUDMAN. Do you know how much he was paid?

Mrs. SAXON. I don't know the amount. It was a percentage.

Senator RUDMAN. Was it substantial? By that I mean in the thousands?

Mrs. SAXON. In the thousands of dollars?

Senator RUDMAN. Yes.

Mrs. SAXON. There were a lot of customers that were referred by Sid Barlow, so if the percentage was 5 percent, it would be substantial, yes.

Senator RUDMAN. What percent?

Mrs. SAXON. If it were 5 percent, which I don't know.

Senator RUDMAN. I see. But at any rate, he was paid some fixed percentage for a customer that was referred from his endorsement to the company?

Mrs. SAXON. That is correct.

Senator RUDMAN. He was also the host of an investment show in which he would give investment advice on his radio program?

Mrs. SAXON. That is correct.

Senator RUDMAN. Was this endorsement of Bullion Reserve by this gentleman given on his program or in some other way?

Mrs. SAXON. Well, it was given on his program, and he also held seminars for Bullion Reserve which he advertised on his program.

Senator RUDMAN. So while he was being employed by the radio station, he was obviously getting some compensation, I assume, from the station; but, also, he was giving investment advice and was an endorser of Bullion Reserve and was getting a commission for that endorsement?

Mrs. SAXON. That is correct.

Senator RUDMAN. To your knowledge, did Mr. Barlow ever publicize on his program or otherwise that he in fact was getting compensation from Bullion Reserve?

Mrs. SAXON. No.

Senator **Rudman**. I think it is too bad we don't have Mr. Barlow here this morning. There are some questions I would like to ask him.

Mrs. Saxon, do you know whether your husband banked in Switzerland or in London?

Mrs. **Saxon**. I don't know.

Senator **Rudman**. You do not know of your own personal knowledge?

Mrs. **Saxon**. No.

Senator **Rudman**. It is my understanding that you in fact traveled to Switzerland on several occasions while working for the company. Is that correct?

Mrs. **Saxon**. That is correct.

Senator **Rudman**. Did you travel there with Mr. Saxon?

Mrs. **Saxon**. On one occasion, yes.

Senator **Rudman**. How many other occasions did you travel there?

Mrs. **Saxon**. On my own, about four, five other times.

Senator **Rudman**. What was the purpose of the trip with Mr. Saxon, your former husband?

Mrs. **Saxon**. He met with a banker at I believe Credit Suisse.

Senator **Rudman**. Say again?

Mrs. **Saxon**. He met with a banker at one of the big banks on the Perod Plaza. I believe it was Credit Suisse.

Senator **Rudman**. Do you know the purpose of that visit? Were you with him during that visit?

Mrs. **Saxon**. Yes, I was. No, I was not in the meeting. I waited outside.

Senator **Rudman**. Well, did your husband tell you what the meeting was all about?

Mrs. **Saxon**. He was looking into opening up accounts.

Senator **Rudman**. In Switzerland?

Mrs. **Saxon**. Right.

Senator **Rudman**. Are you aware of the fact that those accounts were opened?

Mrs. **Saxon**. I don't know if they ever were or not.

Senator **Rudman**. Your former husband never indicated to you whether he opened accounts or not?

Mrs. **Saxon**. No.

Senator **Rudman**. Did you ever see correspondence or other documents that were mailed to your husband either at his work or at home from those banks, from the bank?

Mrs. **Saxon**. No.

Senator **Rudman**. You went to Switzerland four occasions yourself?

Mrs. **Saxon**. Yes.

Senator **Rudman**. What was the purpose of those trips?

Mrs. **Saxon**. Pleasure.

Senator **Rudman**. Pleasure?

Mrs. **Saxon**. Yes.

Senator **Rudman**. You did no banking business for your former husband while there?

Mrs. **Saxon**. No.

Senator **Rudman**. You carried no documents there for him?

Mrs. SAXON. No.

Senator RUDMAN. How about London? Did he bank in London?

Mrs. SAXON. Well, I am not sure. He did business in London. I am not sure if the company is a bank or what it was. It was J. H. Raynor & Co. He had money there.

Senator RUDMAN. So the extent of your personal knowledge is limited to the fact that on one trip to Switzerland with the late Mr. Saxon you were aware of the fact that he was discussing the establishment of a banking relationship with a Swiss bank? That is the extent of your personal knowledge?

Mrs. SAXON. Of my direct personal knowledge.

Senator RUDMAN. Of your personal knowledge?

Mrs. SAXON. Right.

Senator RUDMAN. Since Mr. Saxon is deceased, and I guess I will go a step beyond that, could you tell us what your indirect knowledge might be as to his banking involvements outside the continential United States?

Mrs. SAXON. Well, he told me he was working with another bank to set up Swiss accounts, a smaller bank, that I hadn't heard of before.

Senator RUDMAN. In Switzerland?

Mrs. SAXON. In Switzerland.

Senator RUDMAN. How about any other place, Switzerland, the Bahamas, Caribbean, anywhere?

Mrs. SAXON. Well, he had a company in Hong Kong and he had a bank account there.

Senator RUDMAN. That was the division of his company in Hong Kong?

Mrs. SAXON. Right.

Senator RUDMAN. Any other direct or indirect knowledge of his banking relationships offshore?

Mrs. SAXON. No.

Senator RUDMAN. So, if I can summarize then, you correct me if I am stating it incorrectly—I want to have the record very clear on this point—the extent of your direct and indirect knowledge on your late husband's offshore banking relationships is your knowledge of the discussion of the establishment of an account in Switzerland. You were present on the trip but not present with your husband at the time; you waited outside.

Mrs. SAXON. Right.

Senator RUDMAN. In addition to that, you understand from conversations with him that he had some discussions with a smaller bank in Switzerland, also that he had some kind of banking relationship or business relationship in London, and that he had a bank account in Hong Kong.

Mrs. SAXON. That is correct.

Senator RUDMAN. That is the full extent of it, to your knowledge?

Mrs. SAXON. Right, to my knowledge.

Senator RUDMAN. Mrs. Saxon, the BRNA was in business at about the same time as IGBE in Florida. Did Alan Saxon consider IGBE a competitor?

Mrs. SAXON. Yes.

Senator RUDMAN. Which company was doing the bigger business?

Mrs. Saxon. Alan said Bullion Reserve was doing a bigger business.

Senator Rudman. Do you have any idea of the volume of business of BRNA?

Mr. Matz. At what period, sir?

Senator Rudman. Well, I guess since we want to cover the whole period, let's take it at the low, the middle, and the high.

You have testified previously to this, of course, and I can refresh you recollection. For instance, at one point I believe you stated that they had done $7 million on a particular occasion, but that was a rather large day.

Mrs. Saxon. Yes.

Senator Rudman. What would the range be, to the best of your knowledge?

Mrs. Saxon. In the beginning, it may have been maybe $5,000 a month, $10,000 a month.

Senator Rudman. How about in the last 6 months before it folded?

Mrs. Saxon. The cumulative last 6 months?

Senator Rudman. Yes. What did you do there, by the way?

Mrs. Saxon. I was an advertising manager.

Senator Rudman. How many people worked there?

Mrs. Saxon. About 45.

Senator Rudman. So, you had some feeling as to whether things were going well or poorly or whatever. Would it be unusual for them to do $1 million in a week?

Mrs. Saxon. Oh, no, not unusual at all.

Senator Rudman. $5 million in a week?

Mrs. Saxon. Probably. I mean that sounds like it would be right.

Senator Rudman. About how much business did they do in the last 6 months?

Mrs. Saxon. I never saw any records, but from what Alan would tell me and others, maybe $70 to $100 million.

Senator Rudman. $70 to $100 million in the last 6 months?

[Witness nodding affirmatively.]

Senator Rudman. That squares with some other information we have. The Florida company did $82 million in 1982, and Mr. Saxon felt that Bullion Reserve was larger than that company?

Mrs. Saxon. Yes.

Senator Rudman. I understand the real heyday of this company was late 1982 and 1983 up to his death in September. Is that correct?

Mrs. Saxon. That is correct.

Senator Rudman. To some extent you gaged that by the huge expenditures the late Mr. Saxon was making; is that correct?

Mrs. Saxon. That is correct.

Senator Rudman. Give us some examples of some of these huge expenditures that he was making personally.

Mrs. Saxon. Personally?

Senator Rudman. Personal or business, either one. Why don't you start with personal, and then we can go to business.

Mrs. Saxon. All right. He bought a second car, a Maserati. He leased a Learjet on a monthly basis.

Senator Rudman. Do you know how much that cost?

Mrs. SAXON. Well, he was obligated to fly $30,000 worth a month on the lease. He leased Gulfstream II aircraft on four occasions, which are very expensive. He lived a very extravagant lifestyle.

Senator RUDMAN. Please repeat that.

Mrs. SAXON. He lived a very extravagant lifestyle.

Senator RUDMAN. In fact, is it an accurate statement that he made some trips to Hong Kong for supposedly business purposes but maybe picked up some shirts he had bought there? Is that accurate?

Mrs. SAXON. That is correct.

Senator RUDMAN. Very expensive shirts, Mrs. Saxon.

I ask these questions only to illustrate the lifestyle of people we have come across, the people who run these companies. Tell us about his trip to Hong Kong via Tokyo to pick up some personal items.

Mrs. SAXON. OK. I was not living with him during this period——

Senator RUDMAN. We understand that.

Mrs. SAXON [continuing]. While he did all this.

He went to Tokyo, he told me, to buy some aftershave that he liked, and then he stopped in Hong Kong to buy—to have some custom-made shirts.

Senator RUDMAN. How old was Mr. Saxon at this time?

Mrs. SAXON. Thirty-nine.

Senator RUDMAN. Tell us about any visits to BRNA by any regulatory agency. Did you have any such visits?

Mrs. SAXON. There was one visit in I believe late 1981 or early 1982, and I am not sure what the agency was.

Senator RUDMAN. What was his reaction to that?

Mrs. SAXON. He was very upset.

Senator RUDMAN. Could you elaborate on that? We understand he wasn't present at the time of the visit. Just tell us what his reaction was.

Mrs. SAXON. Yes. Well, he found out that the person had been admitted and given literature on the company. It was a woman. And then he found out, he was extremely upset. When I came home, he was in bed with a headache and he took quite a few aspirins, and he was livid that somebody would be let in the company.

Senator RUDMAN. Mrs. Saxon, the tape recording made by the late Mr. Saxon before his death suggested that the company may have lost upward of $30, $40 million. Does that figure surprise you?

Mrs. SAXON. No.

Senator RUDMAN. It did not surprise you. I guess what I really want to ask you now is were you aware, did you have some inkling during the last 6 months that the company was losing that kind of money?

Mrs. SAXON. Well, in May, I was told by a former president of the company that there was $80 million missing, but I asked Alan about it and he denied it.

Senator RUDMAN. What was your understanding as to how this money was being lost? Was it through his trading?

Mrs. SAXON. I didn't understand how it was lost at that time. I assume it must have been through his trading.

Senator RUDMAN. Do you understand now how it was lost?

Mrs. SAXON. I don't think anybody does.

Senator RUDMAN. Well, they took in a great deal of money, supposedly for clients' accounts, and rather than do what the client had been promised would be done with the funds, they did other things and most of that was in trading; is that not correct?

Mrs. SAXON. Yes, I think so.

Senator RUDMAN. I mean his lifestyle was very high, but that would not account for $30 or $40 million.

Mrs. SAXON. I really didn't look at the records, but I would have to assume that that is——

Senator RUDMAN. From working there, and you worked there for how long?

Mrs. SAXON. Two and a half years.

Senator RUDMAN. Two and a half years, and from observing what went on, you are certainly aware of the fact he had a great deal of trading activities going on himself?

Mrs. SAXON. Yes.

Senator RUDMAN. You never really saw the books and records as to how he was doing with that trading activity?

Mrs. SAXON. No.

Senator RUDMAN. In fact, he was using clients' funds to engage in this trading activity?

Mrs. SAXON. I found that out afterward, yes.

Senator RUDMAN. Did Mr. Saxon ever write checks to you, personally, other than paychecks, on the bank account of Bullion Reserve for nonbusiness purposes?

Mrs. SAXON. Yes.

Senator RUDMAN. Could you tell us what those checks were?

Mr. MATZ. You mean the purpose of them?

Senator RUDMAN. How much they were and what the purpose was, yes.

Mrs. SAXON. Yes. In our marital settlement, he wrote a check to me for $480,000 and a check to each of my children for $10,000.

Senator RUDMAN. Those were company checks, signed by him?

Mrs. SAXON. Yes.

Senator RUDMAN. So those three checks amounted to a half million dollars?

Mrs. SAXON. That is correct.

Senator RUDMAN. That was part of his divorce settlement with you?

Mrs. SAXON. That is correct.

Senator RUDMAN. Of course, you had no idea, and I would have to add it wasn't your responsibility to determine whether or not he was lawfully issuing those checks. He was chairman of the company at that time?

Mrs. SAXON. He was the company. He owned the company. Whatever—everybody believed that he could do what he wanted with the money of the company.

Senator RUDMAN. What other Bullion Reserve money did you receive as part of your divorce settlement?

Mrs. SAXON. I received other money. I didn't know if it was Bullion Reserve money or not.

Senator RUDMAN. Going back to some of your previous testimony, I believe you are unsure whether they were Bullion Reserve accounts or cashier's checks, but could you tell us what additional funds the late Mr. Saxon gave you in addition to that half million dollars we just talked about, which you clearly identified. What other checks you received from him in relation to your divorce settlement?

Mrs. SAXON. Yes. I don't know exactly how many checks for sure, but I can tell you the amount of money, if that is what you want.

Senator RUDMAN. Yes, what was the amount of money?

Mrs. SAXON. The total amount, including the half million dollars written on the Bullion Reserve account, was a million and a half dollars.

Senator RUDMAN. So you received checks totaling $1,500,000, a half million of which you can clearly identify as Bullion Reserve checks, the other million dollars which you cannot identify but came from Mr. Saxon in the form of checks. Whether they be Bullion Reserve or cashier's checks, they came from him.

Mrs. SAXON. Or personal checks. That is correct.

Senator RUDMAN. Or personal checks.

What was the timing of this? When did you receive those checks?

Mrs. SAXON. February and March 1983.

Senator RUDMAN. February and March 1983. And the company folded when?

Mrs. SAXON. September 1983.

Senator RUDMAN. September 1983.

Mrs. Saxon, we are interested in some of the bank financing deals for precious metals. For example, we know that Bullion Reserve dealt with the West Coast National Bank. We understand that Mr. Saxon was friendly with an officer of that bank. Can you tell us how they came to do business and your knowledge of those transactions?

Mrs. SAXON. Well, Alan told me that it—was the office you are speaking of Ned Fenton?

Senator RUDMAN. Yes.

Mrs. SAXON. Well, Alan told me that it—was the officer you are where customers would be offered the option to purchase bullion and only pay for a third of it and then West Coast Bank would finance the other two-thirds.

Senator RUDMAN. Is that the name of the bank, the West Coast Bank?

Mrs. SAXON. West Coast Bank.

Senator RUDMAN. Where are they located?

Mrs. SAXON. Their main office is in Encino, Calif. They have a branch in Beverly Hills.

Senator RUDMAN. Did they ever enter into that transaction?

Mrs. SAXON. Oh, yes.

Senator RUDMAN. So, essentially they had what would be called in the brokerage business a margin situation: If I wanted to buy $100,000 worth of the product from BR, and if my credit was worthy, I would then be able to borrow up to two-thirds the money from that bank to finance the deal; is that correct?

Mrs. SAXON. That is correct.

Senator RUDMAN. What was the officer's name in that bank?

Mrs. SAXON. Ned Fenton.

Senator RUDMAN. Is he still with that bank?

Mrs. **Saxon**. As far as I know, yes.

Senator **Rudman**. I am going to ask our chief counsel to just followup with several questions. I think we are about done with your testimony, Mrs. Saxon.

Mr. **Weiland**. Mrs. Saxon, just so the record is very clear, the chairman asked you about visits to the company by regulatory agencies. I believe you have testified that you are aware of one occasion when a woman from an agency visited the company. You are not aware of which agency she was associated with, is that right?

Mrs. **Saxon**. That is correct.

Mr. **Weiland**. To the best of your knowledge, that is the only time any State or Federal regulatory agency actually visited the premises of Bullion Reserve?

Mrs. **Saxon**. That is correct.

Mr. **Weiland**. Are you aware of any written inquiries the company ever received from a regulatory agency?

Mrs. **Saxon**. No.

Mr. **Weiland**. Is it fair to characterize Mr. Saxon's reaction as one of extreme consternation about having been visited by this woman with the agency?

Mrs. **Saxon**. Yes.

Mr. **Weiland**. Did he advise you and the other employees as to what your reaction should be in the future if you were ever visited by some sort of regulator?

Mrs. **Saxon**. Yes. He said to not let them in and to call the attorneys.

Mr. **Weiland**. To call the company's attorneys?

Mrs. **Saxon**. Right.

Mr. **Weiland**. One other area very quickly. You mentioned that he had a bank account in a company in Hong Kong; is that right?

Mrs. **Saxon**. That is correct.

Mr. **Weiland**. What did the company do?

Mrs. **Saxon**. Manufactured gold krugerrands—bezels for kruggerands and coins and bars—the jewelry.

Mr. **Weiland**. What about the bank account? Do you have any knowledge of what the purpose of that account was?

Mrs. **Saxon**. I believe to conduct the Hong Kong business.

Mr. **Weiland**. Do you know of any currency transactions that Mr. Saxon engaged in?

Mrs. **Saxon**. No.

Mr. **Weiland**. You are not aware of his having transported currency out of the United States, for example?

Mrs. **Saxon**. No.

Mr. **Weiland**. That is all I have, Mr. Chairman.

Senator **Rudman**. Yes, Mr. Matz.

Mr. **Matz**. May I just ask, as a matter of clarification, Senator Rudman, I represent only Mrs. Saxon, but there was mention of two other individuals, Cheryl Emery and Robert McKuen, concerning the Senator's inquiries about Robert Martin or Bob Martin. I think the record may have indicated that Emery and McKuen told my client that they know there was no Bob Martin. I don't think that, in fact, was the case. I would appreciate followup questions in fairness to those other individuals, because my understanding is that they were aware that dealings with the Bob Martin were underway, but they were not aware there was no real Bob Martin.

Senator RUDMAN. Well, I will simply ask you to essentially repeat that recollection for the record.

Your counsel essentially informs us that in your testimony you may have inadvertently indicated that these two employees knew that, in fact, Bob Martin was a bogus character. The fact is, if I understand your counsel's statement, they did not know that. Is that correct?

Mrs. SAXON. No. They just told me of the conversation, but they didn't know he was——

Senator RUDMAN. There is no indication they realized this was really a scam being pulled.

Mrs. SAXON. Right.

Senator RUDMAN. Is that what you were asking, Mr. Matz?

Mr. MATZ. Yes.

Senator RUDMAN. Before you leave, Mr. Matz, do you represent Mrs. Saxon in any proceedings in with she is currently involved?

Mr. MATZ. Do I represent her in other proceedings?

Senator RUDMAN. Yes.

Mr. MATZ. Yes; I do.

Senator RUDMAN. Is there a proceeding before the bankruptcy court at this time?

Mr. MATZ. Yes, there is.

Senator RUDMAN. Is the bankruptcy referee attempting to reach some of these funds that were paid to Mrs. Saxon?

Mr. MATZ. Yes, he is. It is the trustee who is trying to reach the funds.

Senator RUDMAN. Pardon me?

Mr. MATZ. It is the trustee in the bankruptcy court.

Senator RUDMAN. We want to thank you, Mrs. Saxon, for responding to our subpena and being a cooperative witness. We want to thank you, Mr. Matz, for accompanying your client here.

We will keep the record open in the event there are other questions we might want to send to you in the form of interrogatories. I doubt there will be, but we normally keep the record open.

Thank you both very much.

Mrs. SAXON. Thank you.

[Newspaper article in relation to the above, from The Wall Street Journal, dated Tuesday Feb. 28, 1984: "Bullion Reserve Funds Used To Buy Futures, Investigator Says," follows:]

BULLION RESERVE FUNDS USED TO BUY FUTURES, INVESTIGATOR SAYS

LOS ANGELES.—An investigator for the district attorney's office here testified that the $60 million estimated to be missing from Bullion Reserve of North America was used by the firm's late president for commodities futures speculation, to pay gambling debts and other expenses, and placed in his personal bank accounts.

The testimony came as a coroner's inquest began yesterday into the cause of Alan Saxon's death last September. Mr. Saxon was found dead in his home in Venice, Calif., apparently a suicide, shortly after worried customers had demanded that their accounts be liquidated.

The big precious metals firm declared bankruptcy shortly after the death and the discovery that millions of dollars in gold and silver bullion, believed to be stored for customers in a Utah vault, was missing.

The investigator, John Schimkola, said records and witnesses indicated that "$15 million to $16 million" of the missing funds had been diverted from the company directly to Mr. Saxon's personal bank accounts. The rest of the missing money, about $45 million, mainly went to commodities speculation, with some used to pay Mr. Saxon's gambling debts and other "personal expenses."

Mr. Schimkola didn't break down the expenditures more specifically, and said records of what happened to the funds invested in commodities futures weren't complete. The district attorney's office is investigating possible criminal wrongdoing at Bullion Reserve.

In a deposition given to investigators from the New York Attorney General's office, Susan Saxon, Mr. Saxon's widow, said she believed the funds missing from Bullion Reserve might total $80 million. In an interview, however, Mr. Schimkola said he was surprised by Mrs. Saxon's claim and said the evidence he has collected indicates that the loss was only about $60 million. He said the exact amount is uncertain because records kept by the firm are incomplete.

Coroners' investigators testified that the evidence they collected showed that Mr. Saxon had killed himself by running a hose from the exhaust of a motor scooter into the sauna of his home.

In her deposition, Mrs. Saxon said she once confronted her husband with charges that customer funds were missing, and he told her his obligations to customers were covered with futures-market contracts to buy gold and silver. There isn't any evidence that such coverage existed.

Senator RUDMAN. We will call Stanley Marcus, U.S. attorney from Miami.

Would you raise your right hand? Do you swear the testimony you are about to give in the course of this hearing shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. MARCUS. I do.

Senator RUDMAN. I thank you very much.

TESTIMONY OF STANLEY MARCUS, U.S. ATTORNEY, SOUTHERN DISTRICT OF FLORIDA, MIAMI, FLA.

Senator RUDMAN. Will you give your name and address and occupation.

Mr. MARCUS. My name is Stanley Marcus. I am the U.S. attorney for the Southern District of Florida. The location of our main office is 155 South Miami Avenue, Miami, Fla.

Senator RUDMAN. Mr. Marcus, we are very grateful for your taking time from what must be a very busy schedule in south Florida, considering what we have read of your activities there, to come up and help us complete our record as we try to determine what legislation may be necessary to try to get at this problem.

[At this point Senator Nunn entered the hearing room.]

Senator RUDMAN. We have some time problems, unfortunately, this morning, as you heard me say earlier. So, if you would like to summarize your statement, we would really appreciate it. Your prepared statement will be put in the record in its entirety.[1]

Mr. MARCUS. Thank you very much.

I very much appreciate the opportunity to be able to testify and participate in this hearing relating to boilerroom fraud in general and metals fraud in particular. I would like to very briefly describe at least from our perspective the nature of the problem, perhaps how it works, the nature of some of the responses from law enforcement, and some of the outstanding problems and issues in this very important area that still remain.

Briefly put, promoters call it telemarketing. We call it boilerroom fraud. It starts simply enough with a voice on the telephone.

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[1] See p. 190 for the prepared statement of Stanley Marcus.

The voice is invariably convincing, sympathetic, sincere. Victims number in the tens of thousands. Their losses surpass hundreds of millions. The phone calls, the pitches, as they are called in the vernacular, go all over the country: Los Angeles, Dallas, Houston, New York, Miami, Phoenix. Unfortunately, south Florida, with more than 100 phone rooms and perhaps 20 to 30 precious metal trading companies alone, has become a hotbed of boilerroom activity.

The activity, of course, I should also add briefly, extends beyond simply boilerrooms dealing with precious metals. Boilerroom salesmen pitch anything and everything, from oil and gas leases to land parcels to tax shelters to currency to industrial chemicals to specialty items. But at least since 1978, gold and silver, platinum and copper have been king, and the kingdom for these sales has been Florida's Gold Coast.

There are a variety of explanations for that fact, among them included the fair weather, affordable rents, a fast-growing economy, the availability of enormous sums of cash, both legal and otherwise, and the ready access to offshore banking. In addition to that, another reason that is sometimes mentioned for this proliferation of boilerroom fraud, and one I would like to briefly touch on, is a sense that law enforcement in south Florida is overtaxed and preoccupied with handling the problems of drugs and violent crime.

I think it is fair to say that south Florida is faced with a crime problem in many ways that is truly unique. Elements of that problem exist elsewhere, but collectively these elements in south Florida add up to a crime profile of the problem perhaps unique in the United States.

The most serious Federal crime problem, but not the only one, is narcotics. Perhaps 75 percent of all of the cocaine and marihuana, and quaaludes imported into the United States comes through south Florida. We have made the attack on narcotics, violent crime, firearms violations, and corruption among our highest priorities.

We have also devoted recently substantial and increasing resources to the problem of white-collar crime in general, fraud in particular. But when we talk about fraud, we should be very clear that the problem transcends simple boilerroom fraud. It transcends just boilerroom fraud dealing with precious metals. It includes fraud against government, fraud in medicare/medicaid, fraud in the food stamp program, and a variety of other entitlement programs.

The net result has been a massive increase in the number of prosecutions and in the filings in the Federal district courts. I would like to cite just one or two statistics to put this in some context that may be helpful for this subcommittee.

For the period ending June 30, 1983—that is to say, the last fiscal year for which we have statistics—the felony charges increased more than 50 percent from the preceding year and, indeed, there were more criminal cases filed in the Southern District of Florida in the Federal courts than in the Southern District of New York, New York City, and the Northern District of Illinois, Chicago, put together. Yet, the number of judges, Federal district judges, in the Southern District of Florida is less than half the number of Federal judges sitting in the Southern District of New York alone.

Senator RUDMAN. I understand that your office has gone from 40 assistant U.S. attorneys in 1980 to 91 today.

Mr. MARCUS. Yes, sir. There has been a very substantial increase. We are over 92 in our allocated strength, Senator at this point.

I should very briefly like to describe, because I think perhaps it would be helpful, to describe how a typical boilerroom works. Setting it up is cheap and it is simple. All it takes are desks, file cabinets, and a bank of telephones. Sales personnel work hours on the phones and they make huge sums of money.

The methodology is simple: Fast talk and extremely high sales pressure tactics. Inside the boilerroom the din is numbing. Sales people are crammed into close quarters. The music is often blaring. And most of these operations, these fraudulent boilerroom operations, are operated on the basis of what is known again in the vernacular in law enforcement as a Ponzi scheme.

It is very simple. Victims are talked into investing through promises of high profits and then they are strung along through delaying tactics, such as the issuance of small dividends or rebates. Only the most vocal complainants receive any money or metals.

The companies begin with prospect lists that they buy or that they may advertise. And the salesmen start with what is called the front speech. It is designed, simply put, to fan curiosity, interest, perhaps greed. The prospects that seem hot are then papered. That is to say they are sent a sales brochure with exaggerations frequently and misrepresentations. Next comes the followup call, usually a week or so later, then the drive call, then the takeover call, and finally the close, which is designed to get the check in the mail quickly.

The customers that they seek are customers whom they can derive repeat sales from. When the boilerroom nears its breaking point, the salespeople make what are referred to as drop calls. That is to say they offer discounts and premiums such as free trips. And then comes the common scenario, what we again call in the vernacular the bust-out. The owner leaves town or perhaps he just moves down the block and opens up under a new name and starts up a scam all over again.

This is perhaps the most insidious aspect of boilerroom fraud; that is to say, the ease and facility with which owners and salespeople intermingle and move on to other boilerrooms.

Senator RUDMAN. You might be interested that during testimony on Monday, Mr. Faircloth, former attorney general of the State of Florida, who was acting as trustee in one of these bankruptcy cases, said that it would be much more difficult to get a license to be a hairdresser, a barber, or certainly to open a liquor store in the State of Florida than it would be to open this kind of operation.

Mr. MARCUS. I think, Senator, that is a fair statement.

One major prosecution that may be of interest, now pending in the courts in Miami, relates to International Gold Bullion Exchange and its owners and operators, William and James Alderdice. They were indicted in the Southern District of Florida recently on a variety of conspiracy, mail fraud, and wire fraud charges.

The indictment itself lays out, however, an interesting and common methodology. According to that indictment, between roughly November 1979 and April 1983, William Alderdice acted as the president-treasurer, James Alderdice as the vice president and secretary, of the company.

During this time, IGBE was engaged in the business of soliciting orders from cutomers throughout the United States. The business was direct and simple: The purchase and delivery of gold, silver, and other precious metals. By April 1983, according to the indictment, IGBE had amassed more than $140 million from customers seeking to purchase precious metals. The indictment, however, charged that throughout this period of time the defendants were engaged in a scheme to defraud the public through false representations and promises in order to induce customers to do business with them and in order to maintain a continuing flow of cash into the corporation itself.

The Alderdices are charged with having intermingled corporate funds. They are charged with having neglected to purchase metals at or near the time of receiving money from customers. They are charged with having failed to ship metals in a timely fashion. They are charged with having engaged in stalling and delaying tactics, with having failed to maintain adequate vault inventories, with having failed to protect customers' holdings by hedging in the futures market, by misrepresentations, et cetera.

On April 21, 1983, IGBE closed down its operations. Victims of the alleged fraud came from throughout the United States, including individuals from the States of Alabama, California, Florida, Georgia, Illinois, Kentucky, Maryland, New Jersey, New York, Ohio, Rhode Island, Texas, and Washington.

As you well know, IGBE is presently involved in Federal bankruptcy proceedings. This case has not yet come to trial, although it will soon. The defendants, of course, are presumed innocent in the eyes of the law until and unless the United States proves their guilt beyond a reasonable doubt.

There have been other cases raising similar issues and concerns, not just in the precious metals area but often in the oil and gas leasing areas. Just one other I would like to make the briefest reference to, although it goes a little bit beyond precious metals and involves boilerrooms in the area of oil and gas leases.

This concerns an indictment that charged three interrelated corporations and its principals, briefly put, with a variety of frauds: U.S. Oil & Gas, Eagle Gas, and the Stratford Co. Again the charge in the indictment lays out a scenario typical to boilerrooms: Beginning with the phone call to the client, going on to the drive call for the purpose of closing the sale, going on to the load call to attempt to sell as many contracts as possible. The misrepresentations charged included misrepresentations as to the deductibility of the particular investment, it included such claims as "Every penny of your money will be returned in full. You won't be able to sleep at night when you are handed that check for close to a million dollars," and so on and so forth.

How significant is the problem of financial loss in precious metals and in other boilerroom frauds? In my opinion, extremely significant. The records in the bankruptcy court in the Southern District of Florida indicate, among others, the following things.

November 10, 1982, Universal Precious Metals of Fort Lauderdale closes, leaving behind 580 creditor claims totaling $7.5 million. January 1983, JVF Investment of Boca Raton shuts down, subsequently producing 100 creditor claims totaling $1.5 million. April 1983 we mentioned, the International Gold Bullion Exchange shuts down. Creditors claims exceed 23,000 individuals with losses estimated at beyond $70 million.

What are we doing about the problem? We have increased substantially the number of prosecutors and the number of agents looking at sustained investigation and prosecution of boilerroom fraud. It is a top priority of my office.

But let us be clear as to how very difficult and how very time-consuming it is to make and to successfully prosecute these cases in the Federal courts. They are extremely labor-intensive. They are extremely time-consuming. And they are extremely difficult to prove beyond a reasonable doubt.

Can law enforcement do more on this area? Absolutely. Have we done some interesting things in this area? Absolutely. I think this subcommittee should be commended for focusing the light of day on this subject because I think among the most important things that can be done is to awaken and to educate the public to this very serious problem of boilerroom fraud.

I appreciate the opportunity to have been able to make a brief statement.

Senator RUDMAN. Thank you very much, Mr. Marcus. We are most appreciative of not only your being here but what you are doing, and what obviously must be a very difficult assignment for a prosecutor with all of the sorts of problems you have in south Florida.

There were a number of questions that I have. We have some time constraints, as you know. Let me ask you this question: If we deal with this at your end of it, it is almost too late in many ways to really get ahold of this problem. I mean with all of the problems that you have, and considering the ease with these people open their businesses, it seems that for every one that we put on out of business, three springs up.

As you know, there are some conflicting jurisdictional problems between the CFTC, Securities and Exchange Commission, State authorities. From a prosecutor's point of view, what would you like to see done in terms of the laws, the jurisdiction, the State activity, to give you less of a problem to deal with, rather than having to give you more people to deal with it after it happens?

Mr. MARCUS. I would like to make a couple observations. One is the point that I already made, that I think that this subcommittee has done an important public service in focusing the light of day on the problem.

Second, we have begun the task of bringing together State and Federal authorities and you have heard the testimony of some folks from Florida, particularly from the comptroller of the currency. In addition to that, we have worked closely with Jim Smith, the attorney general of the State of Florida.

What we have attempted to do in this area is not only to go forward with indictments but to seek to obtain the issuance of cease-and-desist orders at the same time; that is to say, simultaneously with the issuance of indictments to actually have State authorities put these folks where the proof is clear out of business.

Part of the problem that arises, however, is that no sooner may a defendant be indicted and no sooner may he be put out of business under a particular corporate name but he may reform under a new organization or new name right down the block.

The key again is to keep the pressure on, to continue to issue cease-and-desist orders, to continue to indict, to prosecute, to convict, and to convince the courts that these white-collar crimes are very, very serious and to seek to obtain real and substantial jail sentences as well as substantial fines in order to successfully deter this kind of conduct.

Senator **RUDMAN**. One of the observations made on Monday by the probation officers from your district down there was that even while on appeal, sometimes while in jail, because of the relatively lenient sentences in many cases, and the fact these people come to Florida for probation sometimes, these cases aren't followed up. Do you think we might do a better job in having postconviction followup and revocation of probation and that sort of thing?

Mr. **MARCUS**. I think the area is extremely important. The point is well taken. And I think the postconviction followup ought properly be a matter of very high priority, yes.

Senator **RUDMAN**. We heard testimony from a number of witnesses from various State offices, including the State of Florida, that there is now an attempt to have some uniform laws adopted in the various States to try to make it more difficult for these companies to open their businesses.

Do you believe that that is a project in which U.S. attorneys can convey to State authorities how important that is in terms of what they have to do?

Mr. **MARCUS**. Yes, I think it is an area of great importance. The jurisdiction is concurrent. It is not simply a Federal problem. It is not solely a Federal problem. It is a State problem and a local problem every bit as much as it is a Federal problem. Requirements of registration, capital requirements, insurance requirements, things of this kind are critically important. Full, vigorous regulatory and licensing authority is critically important.

I do want to underscore it isn't simply on the Federal level that we ought to be seeking to do this.

Senator **RUDMAN**. Senator Nunn.

Senator **NUNN**. Mr. Chairman, I know you have a time problem and I have a bill on the floor. I want to thank Mr. Marcus for being here.

The only question I would have may have already been covered. If it has, no need to repeat it. But if you were someone out there in south Florida that had an urge to invest in commodities and were called on the phone, what rule of thumb would you use to try to determine whether this was a fraud or whether it was a legitimate commodity? In other words, what questions would you advise the public to ask?

Mr. **Marcus**. A couple of observations for you, Senator, in that regard. Companies legitimately selling gold and silver and precious metals over the country for perhaps 2 to 4 percent in the way of commissions are for the most part legitimate businesses. What are they asking for? Customers should be wary and leery of businesses that promise easy and sure profits, especially on the telephone. They should be especially leery of the dealer who seeks to defer the delivery of the metal until a later date, or the dealer who sells the leverage contract offering minimum downpayment. The purchaser should be extremely wary of the high-pressure salesman on the phone who seeks the immediate payment of money. He gets on the phone, pressures the woman, the older woman, or man, in retirement, for money, referring to the golden opportunity of these get-rich-quick schemes and demands payment at once.

These are the classic hallmarks and patterns of this kind of fraud. And so I think the key word is to be wary and to be slow to invest your money, to check the companies out in a variety of ways, with regulatory authorities in a variety of State and local governments, in some instances perhaps with the Better Business Bureau as well.

Senator **Nunn**. Thank you.

Senator **Rudman**. I would say to my friend from Georgia probably the best advice from what we have heard in the last few days is if we get a call, hang up the phone.

Senator Nunn, the prepared statement you submitted will be put in the record.[1]

Thank you very much, Mr. Marcus. We appreciate your coming up here from Florida and helping us develop a record. We intend to move forward, I am sure, with some legislative inititatives as we have in the past. Your testimony has been very helpful. Thank you.

Mr. **Marcus**. Thank you very much.

Senator **Rudman**. We will stand in recess until 3 p.m.

[Members of the subcommittee present at the time of recess: Senators Rudman and Nunn.]

[Whereupon, at 10:45 a.m., the subcommittee was recessed, to reconvene at 3 p.m. this same day.]

AFTERNOON SESSION

[Senator present at the reconvening of the hearing: Senator Chiles.]

Senator **Chiles**. Our first panel this afternoon will be Mr. John Fedders, Chief of Enforcement for the SEC; Mr. Dennis Klejna, Chief of Enforcement, CFTC; and Amanda Pedersen, Deputy Director of Consumer Fraud, FTC.

Following our procedures of the subcommittee, if you all would rise, I need to swear you in.

Do you swear the testimony you are about to give before the subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Fedders**. I do.

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[1] See p. 105 for the prepared statement of Senator Nunn.

Mr. **Klejna**. I do.

Ms. **Pedersen**. I do.

Senator **Chiles**. Thank you.

I understand that we have taken your statements in full and they will be inserted in the record.[1] [2] [3]

Senator **Chiles**. If you could give us a brief synopsis of your testimony so we will have a few minutes to ask questions, we would appreciate that.

TESTIMONY OF JOHN FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT, SEC; DENNIS KLEJNA, DIRECTOR, DIVISION OF ENFORCEMENT, CFTC; AMANDA PEDERSEN, DEPUTY DIRECTOR, BUREAU OF CONSUMER PROTECTION, FTC

Mr. **Fedders**. Thank you, Senator. I will summarize my entire statement with six points.

First, some of the marketing of precious metals is conducted through classic boilerrooms and a bouillabaisse of falsehoods to investors. Indeed, a segment of this industry is plagued with lying to, cheating, and stealing from investors.

Second, I wish I could report that the Commission is busy investigating the malefactors, but during its 50-year history it has had a minimal prosecution presence in this area.

Third, the sale of precious metals infrequently involves the sale of a security or investment contract. Consequently, the Commission has no jurisdiction to police much of this fraud.

Fourth, even though there is fraud against investors in the precious metals area, there should be no false hope that the Commission has jurisdiction to protect investors from most of the criminals at work here.

Fifth, the Commission will initiate enforcement actions when metals dealers operate in a fashion that results in a securities transaction.

Finally, the Commission will assist other Federal and State law enforcement agencies as they investigate illegal conduct in the precious metals industry.

The balance of my testimony, Mr. Chairman, relates to the intricacies of the Federal securities laws and how they might apply in this area. With your permission, I will place it in the record and let the summary speak for itself.

Senator **Chiles**. Thank you, sir.

Mr. **Klejna**. Thank you, Mr. Chairman. My name is Dennis Klejna, Director of the Division of Enforcement of the Commodity Futures Trading Commission. We are the Commission charged with the regulation of commodity futures markets.

We appreciate the opportunity of being here today.

The CFTC's primary mission is to regulate the 11 commodity futures exchanges and the nearly 70,000 futures professionals who deal with the public. In addition, the Commission has jurisdiction over leverage contracts and dealer options.

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[1] See p. 199 for the prepared statement of John Fedders.

[2] See p. 204 for the prepared statement of Dennis Klejna.

[3] See p. 210 for the prepared statement of Amanda Pedersen.

As a regulator, the Commission strives to assure that the conduct of regulated commodity professionals conforms to statutory requirements. In contrast, the people we are talking about here today, those who engage in off-exchange fraudulent activity, scorn regulation and choose, rather, to operate outside the legal framework.

When the CFTC appeared before this subcommittee approximately 2 years ago, during your scrutiny of the sale of off-exchange commodity instruments, a key focus of your concern was the inability of State law enforcement officials to utilize the provisions of State law in attacking off-exchange boilerroom activities. We believe meaningful opportunities for increased State involvement in this area were contained in the Futures Trading Act of 1982.

In the 1982 act, Congress enacted a new section 12(e) to the Commodity Exchange Act which eliminated any restriction on criminal prosecution of commodity wrongdoing under any Federal criminal statute. Perhaps more importantly, this open season provision eliminated the preemption of any Federal or State statute or rule with respect to commodity transactions that are not futures contracts traded on designated contract markets or that are not subject to regulation by the Commission as authorized options transactions, leverage transactions, or dealer options.

Section 12(e) also eliminated the preemption of any Federal or State statute or rule with respect to any person required to be registered with the CFTC but who fails or refuses to do so. In short, any statute or rule of any of the 50 States or any other Federal statute or rule may be utilized in attacking so-called off-exchange commodity boilerroom activity.

The gist, to summarize my statement, Senator, is that we stand ready, as we have demonstrated in the past, to assist in any way we possibly can through cooperative efforts and cooperative enforcement actions with State officials and a variety of other ways in helping to attack the problem of off-exchange fraud. We believe we have opened up the availability in this area to the States and to other Federal prosecution.

I would like to highlight just very briefly some of the things that I think we should point out that have been accomplished in this area vis-a-vis cooperation with other agencies.

We have conducted two national CFTC-State Cooperative Enforcement Seminars which have been attended by representatives of 30 States and conducted the first CFTC-State Cooperative Enforcement Seminar on a regional basis in Los Angeles. These things which I am going to discuss have all been accomplished since we last appeared before the subcommittee.

We have begun work on producing a "Commodity Law Violators Manual" which had not existed before. This is for distribution to State and Federal authorities. We have filed 12 cooperative enforcement actions in Federal court with five States under section 6(d) of the act. We worked with officials of the State of Arizona in their taking advantage of section 12(e) by filing the first action in State court alleging fraud with a commodity theme. There was also a case *CFTC and the State of Arizona* v. *Smythe-Wheatley* filed in the last few weeks. I can assure this committee there will be action in the Southwestern part of the United States similar to that within the next couple of weeks.

In addition, in the Federal cooperative area we have endeavored to do all that we can to assist Federal officials in the intricacies of commodity violations. We have conducted a 4-week pilot program for FBI agents. We have conducted training programs and seminars for the Internal Revenue Service in New York and Chicago and for Assistant United States Attorneys in the southern district of New York. We have provided our staff as expert witnesses in Federal prosecutions in Chicago, Dallas, New York, Boston, Miami and San Antonio, and a variety of other matters. We have also met recently with representatives of the Department of Justice Economic Crime Council to help establish the prosecution of commodity-related boilerroom fraud as a national priority.

To sum up, it is our sense that what we are dealing with here, Senator, are hard-core criminals, people who are in the process of stealing other people's money, a kind of callous unlawfulness which is best met by criminal prosecution.

We have I think an excellent record in attempting in the last couple of years, and we will continue to endeavor in the future, to do all we can to assist both State and Federal prosecutions to put these criminals where they belong, which is behind bars.

Thank you very much.

Senator CHILES. Thank you, sir.

Ms. PEDERSEN. Mr. Chairman, I am Amanda Pedersen, the Deputy Director of the Bureau of Consumer Protection at the Federal Trade Commission. I want to thank you for the opportunity to appear here to talk about the Commission's activities in this area.

In this past couple of years, the Commission has committed an increasing amount of resources to law enforcement in the investment fraud area. Since 1981, we have brought seven fraud cases and obtained preliminary or permanent district court injunctions against 41 defendants. We have already obtained and distributed $125,000 in redress funds to defrauded consumers, and in the near future we expect to obtain millions of dollars more in consumer redress.

I would like to give you just a brief overview of our efforts in this area. They have been concentrated in two main areas: investment gemstones and oil and gas lease lottery filing services. However, recent investigations of precious metals dealers may lead to litigation in the future.

Since 1982, we have brought three cases alleging consumer fraud in the sale of gemstones as investments. Industry sources estimate that since 1980, sales to the public of gemstones as investments have exceeded $750 million.

The Commission believes that many of these sales were the result of fraudulent sales presentations that misrepresented, among other things, the liquidity and appreciation rates of gemstones. All of the companies involved in these three actions are now out of business.

One of the Commission's pending gemstone cases is against International Diamond Corporation, formerly the Nation's largest retailer of investment diamonds. The Commission's evidence indicates that investors may have lost over a hundred million dollars as a result of the firm's practices. We do not have any illusions that our litigation can produce complete consumer redress in this area, but we do expect to obtain millions of dollars for consumers.

Since December of 1982, the Commission has also brought four cases challenging suspected fraud in the sale of what are represented to be investment services related to the lottery of oil and gas leases on Federal lands run by the Bureau of Land Management at the Department of Interior. The staff estimates that the sales practices of the telephone boilerroom operators in these four proceedings have caused losses to investors of approximately $70 million.

As a result of Commission action, the 30 corporate and individual defendants named in those matters are now under court orders prohibiting them from making various misrepresentations, including misrepresentations, about the likelihood and value of obtaining oil and gas leases in the BLM's lottery.

Moreover, in the Commission's case against U.S. Oil and Gas, the staff obtained temporary freeze orders preserving assets worth about $12 million for possible redress to consumers. The staff also successfully sought the appointment of a temporary receiver to assume control of the operation of the corporate defendants.

Although the fraudulent practices have already been enjoined, the staff continues to litigate three of these cases to finalize effective relief, and to obtain consumer redress. At the same time, we are pursuing investigations of similar fraudulent schemes. Two more related law enforcement actions will probably be filed in the very near future.,

In addition, the Commission's headquarters staff has identified several precious metals dealers suspected of dealing in high-pressure boilerroom sales tactics. Through contacts with law enforcement officials, the staff is acquiring further information and developing additional leads. This investigation continues and may lead to actions against some precious metals dealers in the future.

Since 1981, the Commission has expanded its program to combat these investment frauds and increased its commitment of resources. In fiscal year 1981, for example, the Commission's professionals spent over 8,000 hours on investment fraud investigations and by fiscal 1983, that number had nearly tripled to nearly 24,000 hours. I suspect that this resource commitment will continue and that the FTC will remain an effective force in the battle against investment fraud.

Since assuming his post in 1981, Chairman Miller has continually voiced his support for these cases and for FTC action.

I do want to mention, however, that the Commission does face some difficulties in bringing actions against investment fraud schemes and, in particular, fraudulent precious metals dealers. The primary difficulty does stem from the Commission's status as a civil law enforcement agency. Our processes for obtaining information from a company are cloaked with substantial procedural safeguards, which may impede the staff from obtaining information quickly from an uncooperative company.

I think in summary I would like to mention that the Commission staff has been involved in a lot of cooperation on the local, Federal and State level with other agencies and that we have found these to be very valuable in facilitating the exchange of information and the coordination of law enforcement actions.

[At this point Senator Rudman entered the hearing room.]

Ms. PEDERSEN. In addition, I want to say a brief note in response to the subcommittee staff statement here recommending public education. Within the Bureau of Consumer Protection at the Federal Trade Commission, we have an Office of Consumer and Business Education that undertakes a wide variety of activities to complement our law enforcement efforts. This office produces fact sheets for consumers on a wide variety of consumer issues. We also put out public service announcements. For example, in response to our first oil and gas case, we put out a "Facts for Consumer" called "Investing by Phone," warning consumers of the danger of boilerroom operations.

These consumer publications are sent to a mailing list of more than 9,000, which includes the media, State, and local consumer affairs offices, libraries, legal services offices, and a wide variety of other groups. These publications can be used by the trade press or consumer writers and that way the information we have developed is disseminated even more broadly.

We see this effort to educate consumers as a very important complement to any law enforcement actions that we undertake. I would like to ask that our fact sheet on gemstone investing and on investing by phone be made part of the record in this proceeding.

Senator RUDMAN [presiding]. It will be made part of the record.

Ms. PEDERSEN. Thank you.

[The material referred to was marked "Exhibit No. 8," for reference, and may be found in the files of the subcommittee.]

Ms. PEDERSEN. That does conclude my summary.

Senator RUDMAN. First let me thank my colleague, Senator Chiles, for getting me out of a tight spot. We had an amendment unexpectedly come to the floor, and at very short notice Senator Chiles very graciously changed his schedule to chair this hearing and open it. I am very appreciative. At this point I will yield to Senator Chiles for some questions, if he would like, since you have heard all three of the witnesses.

Senator CHILES. Thank you, Mr. Chairman. I would be happy to ask a few questions.

First, I would like to ask Mr. Fedders, why is it that Florida has been able to find a security in these boilerroom operations and attack them on that basis but the SEC doesn't seem to share that? Have we got a different definition of what a security is?

Mr. FEDDERS. Senator, the definition many of the States use for a "security" is different from that of the Federal Government under both the Securities Act of 1933 and the Securities Exchange Act of 1934. If my recollection serves me correctly, the States, such as the State of Florida, have moved in most circumstances, by cease and desist orders where there is no adjudication by a civil judge or an administrative law judge as to whether it in fact was a "security"; there is no independent judicial determination made by an individual as to the existence of a "security."

My professional judgment is that in most of these circumstances a "security" as defined in the two principal Federal Securities laws does not exist. This is not running away from a law enforcement responsibility; it is a judgment made with great integrity as to whether or not we have jurisdiction.

Senator **Chiles**. Do we need to change the definition some? Because we are not talking about a small thing. I see the time that the SEC puts into securities matters in areas in which the protection of the public is certainly important, but the amounts we are talking about in those cases are so very much smaller as compared to these cases where we see how high the fraud is. It seems to me you spend a lot of time going after the gnats. I mean how do we get you attacking the camels and the elephants?

Mr. **Fedders**. We think we have not only gone after camels and elephants but gorillas as well.

I think that your suggestion that the definition of securities be expanded is worthy of consideration. I would not endorse it at this time for this reason: The Securities and Exchange Commission has civil injunctive powers, and I am familiar with the kind of person acting in this area; under some circumstances they will line up for civil injunction actions. What you need in this area is criminal authority and more criminal resources.

I think the way these people will be prosecuted is not under the Federal securities laws, not under the laws that are administered by any of the three individuals at this table, but pursuant to criminal wire fraud and mail fraud statutes. That is the way they will be prosecuted and eventually put in jail.

Senator **Chiles**. But you mention the civil injunctive powers, which are very broad, which the SEC has. Injunctive powers, you know, cease an operation. I am just looking at one file which happens to be the CFTC case that they went into with International Gold Bullion Exchange. The SEC got into that case at some point in time, too, or exchanged information. When the CFTC begins its official preliminary inquiry in 1980 and the chronology of this runs through 1983, it seems to me, that there was some activity going on all of that time. A hell of a lot of people and a hell of a lot of money were involved over that period of time.

How do we stop that activity in order to protect the public on this? Part of the concern, when we are looking at these $75, $100 million losses of individuals, is to stop the flow of all those funds. Then we can prosecute somebody.

I address this question to all of you. What do we need to do in regard to the law to be able to come in and close these operations down without dragging on for 3 years?

Mr. **Fedders**. I have not had the opportunity before today to read my other two colleagues' statements, but one thing rang out clear as I listened to each of them. Each of the three of us said it is going to take putting these people behind bars. We each have civil law enforcement responsibilities. Sure, we can close them down for periods of time, but all they will do is go to another State.

My problem is one of integrity. We believe that these people are crooks in the truest sense of the word. But you can't expect in the Nation that has as its creed "equal justice under law" to take some law like the Federal securities laws and bastardize it for the purpose of reaching out in those cases where you don't have jurisdiction.

The laws need to be clarified. These are clearly criminals. The Government needs the resources to devote to this problem. I suggest the resources be applied to the criminal authorities. The malefactors have to be put behind bars. As I said before, there is an element engaged in this misconduct which you can't proceed against civilly; you can't restrain them, deter them or punish them with civil injunctive actions. They will line up for a civil injunctive action. Organized crime will line up for civil injunctive actions. The only thing they want to do is be kept out of jail. I don't characterize these folks as organized crime figures, but there are hard criminals engaged in this activity. Jail is the only thing that will impede them. I can't do that for you.

Mr. KLEJNA. If I could, Senator, underline that point. I was not here on the first day of testimony, but I was made aware of the fact that the State of Florida brought these charts which we have here on the right side of the room which point out how a lot of these people tend to be related. You close down one, another one opens, and they never seem to go away. We have not sued all of them, but we have sued many of them, with the very limited resources we have and the great attention we have paid to that activity in the State of Florida.

But I think that the point really has to be made very clearly. The analogy we use in our office is it is like hitting a piece of mercury with a hammer. All you wind up doing is having a million pieces of mercury all over the table when you hit the mercury with the hammer.

I think that is what civil enforcement tends to do. When we, for example, from a regulatory posture, dealing with the people who are closest to the orthodox part of the futures transactions which we regulate, you can commence an action against, for example, a floor broker on an exchange or a major wirehouse or even a small regional futures commission merchant, and you can engage in expensive litigation over the question of whether you are going to suspend the registration with the CFTC for a matter of 2 or 3 weeks or a month, because you are talking about people who are closer to the mainstream of the business community. These are the people that agencies such as ours are designed to regulate. But you could stack up, until you are blue in the face, frankly, pieces of paper, call them consent decrees, civil orders from State or Federal authorities. When you are dealing with the kind of people we are talking about here today, it isn't going to make any difference. The only thing they are really going to be impressed by is prosecution and jail.

I think that you have an imminent prosecution in some of the matters we are talking about here today. I think that probably all of us at the table are prepared to assist all we can by way of expertise and other ways to assist in that effort. But these people are criminals and that is the most important point that I think has to be made. They are criminals and pieces of paper from Federal agencies are not going to impress them. I think it is apparent because it hasn't impressed them.

Senator CHILES. One of the things that came up in the testimony from Florida is that you can get into this business in Florida, for example, easier than you can get a permit to cut hair, to be a beautician, certainly much easier than getting a liquor license where you have to be fingerprinted and someone checks your criminal record. Yet entry into this is so easy.

We are not trying to create additional paperwork for legitimate people; but should there not be some provisions for the licensing of those people to be admitted to this kind of business and some kind of bonding procedure or something? You are right, they are interested in their liberty. They are also interested in their money. If they had to be bonded, to set up some security, then you will have to get a check on them or they are going to have to be putting up their money. That would be one way of regulating, of determining who can do business, and a way of protecting the public.

Mr. KLEJNA. I don't want by any means to monopolize the conversation.

Senator CHILES. I address that question to all of you.

Ms. PEDERSEN. Senator, let me just follow up a little bit and focus on the experience the Commission has had in this area, which has been relatively recent. We have only been into dealing with investment frauds in the last couple of years.

While I agree that most of the people we have come in contact with may have criminal liability, I think there is a role for civil enforcement to play that complements criminal enforcement. That comes up in two ways.

First, in civil law enforcement, there is clearly a lower standard of proof which in some instances enables us to move more quickly and more effectively. The second point is that while, as I said in my testimony, we don't have any illusions about making consumers whole again, consumer redress is something that we seek. To be able to move quickly, find assets, get them within the purview of the court, and get some of the money back to consumers I think is a very beneficial complement to criminal prosecution and it is one that certainly we are committed to continuing and one that I think is a very appropriate role for the Federal Trade Commission.

In terms of your question about should these people be licensed or should they be bonded, one of the difficulties I would see is that the problem here is the boilerroom operation, not necessarily what is being sold. And so there might be a definitional problem in defining what markets you are talking about unless you are going to talk about the kind of sale, that is telephone boilerrooms, and perhaps impose licensing on those owning more than *x* number of telephones within *y* amount of space. I don't know whether you could get at it that way.

In our experience, where we have at the Commission attempted to use bonding as a law enforcement tool, it has sometimes resulted in people not being able to go into business. We have used it in the health spa area where there has been a problem. I am advised that the State of Connecticut imposed a bonding requirement on health spa operators because of all the problems that have been occurring in the health spa area and that people simply could not get bonds.

Here where we are trying to put people out of business, that might be a very beneficial, noncriminal way to approach the problem.

Mr. KLEJNA. If I might add, Senator, at least from the commodity point of view, and I think it is at least from our point of view a point worth making, especially when you consider what the State of Florida did in the last couple of weeks in the oil and gas lease lottery situation, and I think the Federal Trade Commission, too;

that there is a lot more to this boilerroom concern than commodities. Setting that aside, what the lifting of Federal preemption did in the Commodity Exchange Act in 1982 was to expand the opportunity for States to get involved in not only the enforcement but now the regulatory area in those things which are not regulated by the Commission. And as our submitted papers indicate, we are heavily involved right now in a working group with the North American Association—North American Securities Association—Securities Administration Assocation. It is either that or just NASAA. We always get them mixed up, whether it is the space shuttle or whether it is the securities people, but usually it is the securities people.

At any rate, our efforts with both NASAA and with the National Futures Association to develop model State legislation that may conceivably—we are in the beginning stage of this—but could conceivably encompass those things.

That is not without its possible pitfalls. It is going to be very difficult. There are a lot of legitimate metals dealers that are not subject to regulation by anybody now. The difficulty, of course, in all legislative efforts is crafting something that really attacks the problem and doesn't drag a lot of other people into it that don't belong there.

But this is now an opportunity for State legislation that exists since this committee's work 2 years ago and the passage of the legislation in 1983, and we are working very hard to that end. We have another meeting set up in about a week with these officials. We are going to be moving toward accomplishing something in terms of model State legislation over the next several months, hopefully by the end of the year.

So what you suggest can conceivably develop out of that kind of process.

Mr. **FEDDERS**. I don't disagree with my two colleagues, but I would point out that if a person is a hardened criminal and prepared to engage in the kind of misconduct that would subject him to penalties that would deprive him of liberty, as opposed to simply a civil injunction, the further steps of avoiding registering or avoiding bonding are nothing to him. These people don't care about such things. If the law says you are supposed to be registered and you are supposed to be bonded, they will avoid those requirements because they are playing for bigger stakes.

Civil laws, the kinds of laws we administer at the Securities and Exchange Commisson, are to prosecute people who are generally honest business people, but who tend to need a structure in which to play—participate in our capital markets. You can prosecute and sanction these people with civil laws.

The minute someone makes up their mind that they are prepared to risk their liberty, they may ignore registration. They may ignore bonding. They are going to avoid all regulation because they are playing for a much higher stake.

Senator **CHILES**. I understand that. I am going to turn this over here, but one other thing interests me. Could there be a process where if one is not registered or not bonded, you could cut off the right of public advertisement. It would be necessary that they show some registration or bonding number. They are sucking in the public with these big ads in the paper, as you know. They use tremendous ad campaigns. If you could find some procedure that allowed you to restrict that or cut that off, then I think you may make it much more difficult for them to suck in the money from the public.

Mr. **Fedders**. I agree with you to this extent: If you will both impose upon them the burden of registration and require the media that runs the advertisements to check their registration before they publish their advertisements, then you have both the zipper and the button fly. But with only one and not the other it would not be effective.

Senator **Chiles**. I understand that. I think if you add some provision that exposed the media to claims in the event that they had failed to check, then you would find the media checking these people out very diligently.

Senator **Rudman**. Thank you very much, Senator Chiles.

Mr. Fedders, I find your commentary on these people quite accurate. These are thieves and scoundrels. I am not sure I share the distinction you make between normally honest businesmen under civil law and normally dishonest businessmen.

[At this point Senator Chiles withdrew from the hearing room.]

Senator **Rudman**. What you are saying is that these people are thieves all of the time, the ones we are talking about, and people you are talking about, who engage in some rather interesting insider trading, these are thieves just some of the time.

Mr. **Fedders**. If you study the conduct of malefactors, which we unfortunately have to do a great deal of the time, that is in fact what we are dealing with. I do believe most businessmen and businesswomen want to comply with the law, and their tendency, particularly in the insider trading area, is to not be hardened criminals. These are persons who are overcome by greed in a certain moment.

Senator **Rudman**. Well, the difference is that the folks we have been talking about the last few days have been overcome by greed all of their moments.

Mr. **Fedders**. But that is a big psychological difference and a big difference in their personality makeup.

Senator **Rudman**. Let me ask you this question: I tend to agree with your analysis about the civil law. You may recall back about 8 or 10 years ago there was a scam in another area. It was called "Dare to be Great." It was a fellow named Lynn Turner, I believe. We are talking about large sums of money.

As attorney general in New Hampshire I brought the first action against Mr. Turner.

I agree with you fully. Civil restraints don't mean anything to people like that. But you are talking about tough criminal prosecution, tough criminal prosecution in an area that sometimes the very senior U.S. Attorneys don't have that much experience.

Under certain circumstances, would you be willing, to help the U.S. Attorneys by delegating some of your staff to serve on a temporary basis as Assistant U.S. Attorneys in such places as Miami and Los Angeles?

Mr. **Fedders**. Under certain circumstances I would. But those circumstances would have to be where the use of our resources promoted the enforcement of the Federal securities laws. I cannot assign staff to such a project on my own authority. I would have to check with the Commission. But we have discussed this in preparation for my testimony. It isn't simply taking resources from securities law enforcement and using them in some other area. Because of our mandate, because of the responsibility we have to the investing public, there has to be some benefit to the Federal securities laws in this process.

But generally, yes. I agree with the concept you have mentioned. Let me point up a problem. I have talked to Mr. Weiland of your staff, who has done a tremendous job in putting these hearings together, about particular problems regarding the allocation of staff in Miami. First, we have a very small office in Miami. Second, you know what salaries the Government prosecutor commands. You also know the small per diem that a Government employee is given when he is going to Miami.

I have had marvelous cases, cases that could have a great impact on young attorneys' careers, and I said I needed a few to go to Miami for 6 weeks, 6 months, to work on these cases. From 191 people I could not get a single volunteer. They said, if we go down there on that project, we will lose money. We can't afford to go on the per diem and work on these cases. It will cost us roughly $20 a day out of our pocket. There was not a single volunteer.

Senator RUDMAN. That is something I think this subcommittee ought to address, and I assure you we will. There are circumstances where we really can't afford to do without the resources.

The problem that we face in the subcommittee, and we are winding up these hearings in a few moments today, is this: The FTC does excellent work in a number of areas, in some cases doing a great deal of work for what I would call a relatively small financial return to consumers and in other cases a large financial return, but certainly small on the CFTC scale. Certainly your agencies get tremendous amounts of resources, sometimes dealing with $1 million or $2 million. One I am recently familiar with was about $400,000 or $500,000.

Here we have an instance where we don't have a firm handle on the figure, but after chairing these hearings for a couple of days and last year, I am going to tell you that my own estimate at this point is that people in this country are being cheated out of a sum of money somewhere in excess of a half billion dollars annually. We have some real problems in terms of (a) Federal jurisdiction and (b) what kinds of sanctions we are going to apply.

It may well be that we are going to have to expand certain jurisdictions of some of these agencies because it is a problem with which the States need some help with.

I also believe the States are going to have to do more than they have been doing. From the testimony, I think they are starting to do that. For instance, Mr. Marcus, the U.S. attorney in south Florida, Miami, fresh from the war zone, testified this morning that he went from 40 assistant U.S. attorneys to 91, and indictments went from 800 to 1,200. You name it, they have it: drugs, violent crimes, and securities scams. It is all there.

He said this morning that although he agrees completely that criminal prosecution is vital and primary, that pressure of all kinds from Federal regulatory agencies is a very important part of this. Let me just quote from Mrs. Saxon this morning, the wife of deceased Alan Saxon of Bullion Reserve in California. She said a regulator, an investigator, from an agency walked into their office, and her husband came home that night and was essentially terrorized. He really threw him off his pace.

I am not saying it is going to stop them, but essentially these people work without any interference of anybody.

So, I guess you may be hearing more from the subcommittee, on some thoughts we have in the way of changing jurisdiction.

Let me ask a question of Mr. Klejna. I know this may be a difficult question for you, but isn't it true, that you did everything you could to try to get the FTC to move against International Gold Bullion Exchange?

Mr. KLEJNA. Well, you are right, Senator, that is a——

Senator RUDMAN. I mean you really tried.

Mr. KLEJNA. I think, the record indicates, that we tried very hard to convince not only the Federal Trade Commission but perhaps even other State officials and a lot of people, I guess that this was something that we felt we didn't have jurisdiction over and it appeared to be a problem.

Senator RUDMAN. And the FTC essentially told you it may have been very accurate. Based on their staff and funding—I am not criticizing the FTC; I am just trying to build a record here. They said the IGBE was just a little bit too big, that it was too big a case for them to get into at that time. Is that accurate?

Mr. KLEJNA. I don't want to be reluctant to answer that one, but I have to say that we have looked over our records of these discussions and I don't know whether that was the exact response. I frankly was not involved in any of the meetings, so I don't know if that was the answer. But, at any rate, I just don't know.

Senator RUDMAN. Do you recall what the response was?

Ms. PEDERSEN. I don't know precisely what conversation you are referring to, but I would like to give you just a capsule explanation of the Commission's review of the IGBE and why it was we didn't take any action. It is spelled out in considerable detail in my testimony.

Senator RUDMAN. It is in your testimony and I am aware of it.

Ms. PEDERSEN. I think it is very important.

There were really two phases that the Commission looked at it, during the period of 1981 to 1982, where there appeared to be some problems. We were suspicious. That was the beginning of our involvement, in investment fraud, expanding from an agency that dealt in sort of sophisticated economic problems and big paper cases into the investment fraud area. We were developing our expertise at that time.

We were suspicious of IGBE, but the problems that appeared to us from talking to various State and local and other Federal agencies did not, obviously, lead us to action. We found that while there were complaints about late delivery, by and large they were resolved.

In our expertise with the mail order rule, ordinarily when we have a mail order problem there will be huge volumes of complaints. Four thousand in a couple of months is a typical experience when we have a mail order problem. And the mail order jurisdiction—I won't go into it unless you want me to—is not obvious in IGBE. It is fraught with problems from a technical legal point of view. So that as a practical matter we had the oil and gas cases which involved very substantial amounts of money that were cases we could put together from the computer operations in other Federal agencies. Thus, we were able to avoid the kind of discovery and process problems that I described in my testimony. And the problem with IGBE, while we were clearly suspicious, did not seem to be of the clearcut variety that we knew we had in the oil and gas area.

Later, in the very end of 1982 and in early 1983, when the Chicago office was investigating, it was clear there was a big problem. Gold prices had gone up. There were massive complaints. And the office was moving very quickly at that point to take action.

The documents we have submitted to you shows that. We were prepared to go onto a full-phased investigation. The staff was working on injunctive relief and a complaint, the very same procedures that we have used in the oil and gas area. But Florida and Illinois acted using the hook not of the FTC but the Securities Act, which enabled them to act very quickly.

At that point, and this is from January to April 1983, it was then a question as to whether there was any role left for the FTC to play. And the conclusion was there was not.

As a practical matter, it is true, without question, that the FTC did not act. But I think you have to look at what was available to us and in terms of when the evidence of non-delivery arose.

I think there was a very significant change in the way that IGBE did business, which coupled with the rising gold prices in the summer and fall of 1982, really led to it converting from perhaps a more speculative kind of fringe operation to one that was a real Ponzi scheme and going to go belly-up, which is what happened to it.

Senator RUDMAN. I appreciate your answer. I certainly am sure it is an accurate answer. I think what we are really going to come to the conclusion after the hearing is concluded that the U.S. attorneys are so busy with drug cases and major crime and violence and so forth, that they don't give this the priority that they should. The FBI is so busy with so many things they don't give it the priority they maybe ought to. Maybe they are prioritizing correctly. The State authorities complain in some cases the laws of preemption have given them problems, although not so much in this particular area. Your agencies, for very good and valid reasons, don't necessarily have the criminal statutes in the case of SEC certainly, or CFTC to move.

The net result is we have a big problem around here. Maybe it is a half billion dollars' problem or maybe a billion dollars' problem. But it is going to take some real work.

I am going to suggest to the chairman of the subcommittee, Senator Roth—I serve as vice chairman—one of the things we should do is put together some sort of a small, ad hoc task force of some State people, some people from your agencies, from the various parts of Justice, and see if there is a way to address it. It is a real problem. The Federal Government is protecting a lot of people from a lot of things that are costing the American public a lot less than this is costing.

We have had some stories told here. I am sure you read in the press this morning, some terrible personal tragedies, people losing their life savings, being wiped out, suicides, health problems, older people putting in $30,000, $40,000, $50,000 in what they thought was a legitimate investment and finding nothing left. We really have to find a better way.

Let me conclude this panel with a question I am curious about. I am sure all of you are familiar with publicity in the press on the J. David & Co. out in San Diego. I guess that was a foreign currency trading situation. There is some question as to whether or not there will be a real return to the investors or whether they will lose it all. There is some question of that right now. But it is a huge amount of money.

Do any of your three agencies have this under investigation, monitoring it or anything of the sort? I will start with the FTC.

Ms. Pedersen. I didn't catch the name of it, sorry.

Senator Rudman. J. David & Co. in San Diego. There was a big story on it this morning in the Wall Street Journal.

[The newspaper article referrred to from the Wall Street Journal, Wednesday, Mar. 21, 1984: "Currency Caper, Can Investor Get Any of $150 Million Back From J. David & Co.?" follows:]

Can Investors Get Any of $150 Million Back From J. David & Co.

(By Frederick M. Muir)

San Diego, Calif.—For Jerry David Dominelli, the Huxley quotation apparently summed up his philosophy, as he put it on the front page of brochures given to potential clients of his J. David & Co. investment schemes.

He appeared, in fact, to be in total control of his life. At 42, Mr. Dominelli was running a growing financial empire specializing in foreign-currency trading that promised investors phenomenal annual returns of 40% or more. He counted among his clients many of this city's political and cultural elite after he made generous contributions to their causes. And he teamed up, professionally and personally, with a vivacious, well-connected woman with whom he shared a $750,000 home.

But his empire started to crumble recently when investors tried unsuccessfully to get their money back, and a San Diego bankruptcy court last month named trustees in response to an investor suit to force the company to liquidate.

Mr. Dominelli subsequently was jailed for a day for failing to cooperate with the trustees, and a hearing is scheduled in federal district court here today in part to determine whether Mr. Dominelli has been cooperating in the three weeks since his jailing. Meanwhile, a federal grand jury is investigating possible criminal charges.

The big question is what has happened to as much as $150 million in investors' funds. Investors charge in several suits that they have been defrauded by J. David & Co. Mr. Dominelli claimed at a press conference that the investors have merely been inconvenienced because of back-office problems, but he hasn't answered the suits, and he hasn't been accessible to the press recently.

WHERE IS THE MONEY?

But it seems increasingly unlikely, as the investigations proceed, that J. David & Co.'s 1,500 investors will get much of their money back. Many of the firm's clients were wealthy investors, lured by the promise of sizable returns and utmost privacy, with most records kept outside the U.S. At a meeting of 300 investors a few weeks ago at a private school in affluent La Jolla near here, the parking lot was packed with expensive Mercedes, Porsche and BMW cars.

Mr. Dominelli's reluctance to produce the company's records has heightened investors' anxiety. "Until we see the money," says Ronald Orr, attorney for the court appointed trustees, "we are assuming there isn't any."

Mr. Dominelli, described by associates as pensive and very private, won't discuss details of the case. But interviews with dozens of people who have had dealings with him over the past decade paint a picture of a man who, until about four years ago, led a fairly humdrum life and had a fairly mediocre business career.

Born and raised in Chicago, Mr. Dominelli joined the Marine Corps after graduating from parochial high school. He got a bachelor's degree in political science from the University of San Diego and attended a small law school for a year before beginning his first professional job: account executive with Equity Funding Corp., the insurance company that collapsed (a year after he left) in a major scandal involving fraudulent policies.

OTHER EMPLOYERS

Between 1972 and 1976 Mr. Dominelli worked for four different brokerage firms before ending up at the La Jolla, Calif., office of what is now Prudential-Bache Securities. To hear former colleagues and supervisors tell it, Mr. Dominelli didn't exactly burn up the track.

"There was nothing particularly distinguishing about him," except perhaps the currency trading losses in Mr. Dominelli's personal account, recalls William Taylor, Mr. Dominelli's boss at Prudential-Bache. And, he says, Mr. Dominelli's profits appear to be overstated and his losses understated in a listing of his personal track record later handed out to potential clients of J. David.

Another former supervisor describes Mr. Dominelli as "your basic stock and bond broker," without much flair for commodities or currency trading. And a broker who handled one of Mr. Dominelli's personal accounts says there were constant margin calls on his currency trading positions.

It was at Prudential-Bache, in fact at the next desk, that Mr. Dominelli met broker Nancy Hoover and struck up an immediate friendship with her. Mrs. Hoover, tall, blonde, attractive and three years his senior, started spending more and more time with Mr. Dominelli, slightly paunchy and hair graying. Later, Mrs. Hoover and her husband, also a stockbroker, were divorced, and she started living with Mr. Dominelli. (Mr. Dominelli, who is separated from his wife, has two daughters.)

Mr. Dominelli started J. David & Co. in late 1979. A little more than a year later, he hired Mrs. Hoover as president of newly formed J. David Trading Co., a commodities broker. If the move was convenient for personal reasons, it also appeared brilliant for business reasons, because Mrs. Hoover knew all the right people.

A liberal Democrat, she was once mayor of the nearby affluent enclave of Del Mar. Mrs. Hoover appeared frequently on the society pages of local newspapers. She sat on the board of the San Diego Symphony Orchestra Association, remained active in civic affairs and made friends with politicians of all persuasions. "Nancy had an awful lot of credibility in the community," says M. Larry Lawrance, managing partner of the Hotel del Coronado here and a former investor with J. David.

In some ways Mrs. Hoover seemed the opposite of Mr. Dominelli. She enjoyed the spotlight; he shared it reluctantly. He dressed in dark, conservative three-piece suits; she frequently wore slacks and a sweater and walked around the office in stocking feet. She had a easy-going demeanor; he often seemed to be brooding or in deep thought.

The couple lived in luxury. Besides six homes and three jets, there were more than two dozen expensive automobiles. They supported auto-racing teams and athletic endeavors, but also lavished hundreds of thousands of dollars a year on local arts organizations and charities.

Mrs. Hoover, who is named as a co-defendant in most of the suits filed against J. David, hasn't been available to answer reporters' questions.

PROMISE OF 40 PERCENT RETURN

Mr. Dominelli's empire grew mainly by word of mouth, based on the claim that investors could regularly earn 40% or more annually, in considerable privacy, by having J. David pool their funds and invest them in the arcane and highly volatile interbank currencies.

Even after his staff grew to 270, Mr. Dominelli claimed he did all the currency trading by himself from his command post at the luxuriously appointed, J. David office in La Jolla. (The headquarters, despite its dark woods, antiques, brass fittings and frosted glass, impressed some visitors as "bordello-chic." Incongruously, several office cats roamed at will through the maze of financial news wires and computer screens.)

One asked how he could single-handedly do all the currency deals in a market dominated by 24-hour trading desks, Mr. Dominelli said that his strategy was to get in and out of the market quickly, liquidating nearly all his positions daily and never having a position open over a weekend.

Other currency traders scoff at that. And interviews with traders at six major banks indicate that none had heard of Mr. Dominelli before last month. If he had been conducting the level of business that he claimed, the traders say they would have been aware of it.

CLEARING HOUSES

Mr. Dominelli insisted until recently that he was able to trade anonymously because he cleared all his transactions through Drexel Burnham Lambert Inc. or a unit of Merrill Lynch & Co. But it has been learned that Drexel dropped J. David around the middle of 1982 and Merrill Lynch followed six months later. Neither firm will comment publicly, but a Drexel Burnham official says the firm was concerned about differences between actual trading results and results as reported by J. David.

As investors poured millions of dollars into the firm, suspicious law-enforcement agencies and government regulators started looking into the company's claims. But the interbank currency market isn't clearly subject to regulation, and jurisdictional and budgetary problems helped keep investigators at bay. Investors, at any rate, weren't complaining.

Privacy was central to the J. David operation. Not only were most books and records kept outside the U.S. but transactions were routed through subsidiaries such as a bank based on Montserrat in the West Indies and a mutual fund on Guernsey in the Channel Islands.

Former top officials of J. David claim that only Mr. Dominelli saw all the records of the currency-trading operation, the heart of a business that had grown to include an insurance subsidiary and a stock-brokerage operation. "Some of us knew about the pieces, but only Jerry knew what the whole puzzle looked like," one executive says.

Records that have surfaced seem sloppy or incomplete. When Thomas D. DiNoto, a TV jingle producer, invested $2 million last November, he got a handwritten dimestore receipt imprinted "Received with thanks." Monthly statements sent to investors provided little more than the account balance at the beginning and end of the month, and a percentage gain or loss. There wasn't any indication how the funds had been invested.

TAX-DODGE EVIDENCE

Many of the statements had a "please advise" line where the client's tax-identification number should have been, leading authorities to suspect that at least some customers, both U.S. and foreign, were trying to dodge taxes on their profits.

"You've got to be kidding if you think I'd declare this on my income taxes," says a retired stockbroker who invested $25,000 with J. David. The broker believes many wealthy investors will walk away from large losses rather than invite scrutiny of their affairs by the Internal Revenue Service. Mr. Dominelli has balked at turning a client list over to investigators.

While at least one law-enforcement agency believes Mr. Dominelli may have engineered a classic Ponzi scheme in which early investors are paid off with funds from later investors, there isn't much evidence that many people got much cash out of J. David.

Kenneth A. Jensen, a Cerritos, Calif., carpet manufacturer, invested $150,000 starting in March 1981 but let the money roll over until his account climbed to $340,000—on paper. He is suing to recover the amount.

One investor who got his money and profits back was San Diego Mayor Roger Hedgecock. The Republican mayor invested $45,000 in the currency market as part of a transaction in which Mrs. Hoover arranged a $165,000 personal loan for him. The California Fair Political Practices Commission, a state agency, is investigating whether all financial ties between the mayor and J. David executives were properly disclosed. The mayor says he didn't violate any reporting regulations.

GOLD-MINING INVESTMENT

Mr. Dominelli was liquid enough last July to pay $2.5 million for a 15 percent stake in a California gold-mining company that has ties to members of the administration of former California Gov. Jerry Brown. But by last fall, routine office bills started becoming past due, and Mr. Dominelli missed payments on mortgages for several of his homes. Employees discovered later that premiums for their health insurance hadn't been paid since October.

Even as unpaid bills piled up, Mr. Dominelli continued planning new offices and hiring workers. And he kept paying more than the going rate. "If an operations manager was earning $20,000 with a Big Board firm, Jerry would pay $30,000," one trader says. A financial executive says that even his barber was hired as a salesman by Mr. Dominelli. "That's when I knew it wouldn't last much longer," he says.

The beginning of the end came late last year, when J. David shook investors' confidence by advising its foreign-currency trading clients that the company would start taking a management fee of 1 percent of all funds invested instead of the previous charge of 20 percent of a client's profits. This was followed by an advisory that some operations were being shifted to Switzerland from London.

Investors scrambled to get their money back, and Mr. Dominelli scrambled to stay afloat. San Diego bankers say he came calling with requests for short-term loans. "He seemed very naive," says one banker. "He said he had $10 million on the way from Switzerland, and he needed $100,000 for four days."

TAPPING FRIENDS

Mr. Dominelli and Mrs. Hoover began tapping their friends in society and cultural circles. Mr. Lawrence, the hotelier, made a loan of $1 million on Feb. 7, and two San Francisco investors lent $500,000 the same week. Mr. Dominelli claimed he had repaid nervous investors $25 million since the beginning of the year, but investors say many of the checks started bouncing.

Investors, and even a former business partner began filing suits, some seeking to force J. David into involuntary liquidation proceedings under Chapter 7 of the federal Bankruptcy Code. By the middle of last month, the trustees had been appointed to try to figure out the J. David puzzle. So far, only around $500,000 in cash and assets have been recovered.

The question remains: What happened to the $150 million or so of investors' funds? Even Mr. Dominelli's extravagant lifestyle and his free-spending corporate ways couldn't account for all the funds, observers believe. Some of Mr. Dominelli's close associates and others suggest that he had large currency or commodity trading losses that he covered up while trying to make good on them.

"Jerry's the only one who knows" where the money is or if there is any left, says Mark Yarry, formerly the president of J. David's Montserrat subsidiary. And despite all that has happened some customers still want to believe in Mr. Dominelli. At the gathering of about 300 investors in La Jolla the other week, one insisted. "Jerry is a genius!" Shouted another over the din of the crowd: "Leave him alone; let him trade again."

Mr. Dominelli made a half minute appearance and asked the investors to trust him. He then left abruptly, accompanied by bodyguards, and ducked into a BMW waiting with its motor running.

Ms. **Pedersen**. Senator, I would have to say I am not familiar with it. I can report back to you in confidential sessions about ongoing investigations.

Senator **Rudman**. Mr. Fedders, is the SEC involved?

Mr. **Fedders**. Yes, we are. I would rather not address this specifically. I don't want to suggest to you we have a score of people in there. But we are involved in an inquiry and have been for several months.

Mr. **Klejna**. We are also aware of it, Senator. We as a matter of general policy, similar to what Mr. Fedders has said, we will not confirm nor deny the existence of inquiries. but the Commission is certainly aware of the situation.

Senator **Rudman**. I understand the reasons for your answers. That is good enough.

I am quite serious about seeing if we can address this because we can have hearings ad infinitum and have as many horror stories as there are to tell, but we won't solve the problem. I do think there are some real gaps here, if not in jurisdiction, as to the level of enforcement. It is going to take education, Federal action, State action, model laws, and criminal prosecutions. But this is a problem that is growing, growing by leaps and bounds. A lot of people are being victimized. We are probably going to ask for your assistance in the coming months. I thank you all very much for being here.

Mr. KLEJNA. This is a purely technical matter, but I think it is worth noting. I don't mean to carry on a long time. If I could just ask that the subcommittee accept into the record a joint statement of North American Securities Administrators Association and the CFTC on the lengths we have gone to try to cooperate with each other. I think, as the chairman is aware, it goes a long way in the development of amicable relationships.

Senator RUDMAN. We are pleased with that. The subcommittee took the leadership last year to get more cooperation between the States, and we are glad that is working. As requested, the statement will be made part of the record.

[The material referred to was marked "Exhibit No. 9," for reference, and follows:]

EXHIBIT NO. 9

JOINT STATEMENT OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION AND THE COMMODITY FUTURES TRADING COMMISSION

The North American Securities Administrators Association ("NASAA") and the Commodity Futures Trading Commission ("the Commission") commend the Senate Permanent Subcommittee on Investigations for its work over the past two years in focusing attention on the problem of off-exchange commodity-theme frauds.

As a result of the desire of the Commodity Futures Trading Commission and the state officials who comprise NASAA to combat these types of fraudulent activities, there has emerged an attitude of cooperation which has led to progress in dealing with these types of frauds.

This cooperation is evidenced by the recent appointment by the Commission of E. C. Anderson, Director of Securities, Office of Comptroller, State of Florida, and the Chairman of NASAA's Commodity Committee, to the Commission's Advisory Committee on CFTC-State Cooperation. This appointment coincides with the appointment to that Advisory Committee of Robert K. Wilmouth, President of the National Futures Association (NFA), the self-regulatory organization of the futures trading community. These appointments will enhance opportunities to discuss areas of mutual concern and devise means of better coordination of our efforts.

NASAA, NFA, and the Commission have cooperated in the formation of a task group to draft model legislation, as contemplated under new section 12(e) of the Commodity Exchange Act (1982 amendment), designed to dovetail with the federal statute in order to give the states more efficient tools with which to combat commodity-theme frauds through both criminal and civil procedures. Additionally, NASAA, NFA and the Commission have committed themselves to an education effort aimed at those who would be likely victims of such frauds.

The Commission has established within its Enforcement Division a liaison unit whose primary responsibility will be to provide information and expertise and to assist state authorities in the pursuit of off-exchange fraud. The Commission has also begun work on producing a "Commodity Law Violators Manual" which will be distributed to state and federal enforcement and regulatory authorities.

A number of joint enforcement cases have been filed or are presently under preparation. These cases will begin to build a body of law on which future actions will rest.

NASAA and the Commission want to go on record as maintaining a mutual commitment to the goal of effectively dealing with fraudulent operators who prey on trusting citizens with commodity-related scams. Through the regulatory, enforcement, and education efforts set forth above, we hope to create a legal framework which will enable us to more efficiently utilize our limited resources against this growing area of concern.

Mr. FEDDERS. Senator, anything we have said, any of the three of us, shouldn't give you the impression we believe that all these people are acting improperly, that we believe they are all folks who have engaged in misconduct. Jurisdictional limitations place an enormous responsibility to assure that it enforces its laws and only those laws. The criticism that could be leveled at us for trying to use the Federal securities laws is that in some cases it would be like going after prostitutes, or a lot of other things. I don't mean to be cute with you, because these are very, very difficult issues. The three of us join in applauding you on the initiatives you have brought to this particular exercise because it calls attention to a problem that exists, a gap that is in the law, and indeed we would be prepared to admit a gap in civil and criminal law enforcement. Anything we can do together to work with you we will do. But we must each be responsible to our own charter and mandate under the laws which we enforce.

Senator RUDMAN. We appreciate that very much, Mr. Fedders. We certainly are not critical of any of the agencies here. We are just trying to find a way, as you put it, to solve a problem that exists. We just don't know how to solve it yet, but hopefully this year we will come up with a better way.

Thank you all very much.

Mr. FEDDERS. Thank you for inviting us.

Senator RUDMAN. Mr. Joseph Harrison, National Futures Association, and Luis Vigdor, Industry Council for Tangible Assets, if you would come forward.

Any of you who are going to testify, I am going to have to administer the oath. Are all of you going to testify or just two of you?

Mr. HARRISON. Mr. Driscoll and Mr. Campbell are here to answer questions.

Senator RUDMAN. All raise your right hand. Do you swear the testimony you are going to give in the course of the hearings shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. HARRISON. I do.

Mr. DRISCOLL. I do.

Mr. CAMPBELL. I do.

Mr. VIGDOR. I do.

TESTIMONY OF JOSEPH H. HARRISON, JR., VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL FUTURES ASSOCIATION, ACCOMPANIED BY DOUGLAS L. CAMPBELL, NFA DIRECTOR OF INVESTIGATIONS, AND DANIEL A. DRISCOLL, NFA VICE PRESIDENT-COMPLIANCE; AND LUIS VIGDOR, CHAIRMAN OF THE BOARD, INDUSTRY COUNCIL FOR TANGIBLE ASSETS

Senator RUDMAN. I first want to thank you very much and apologize to you for the change in schedule. I hope we haven't caused you any problems with your travel plans. We had a major change in our schedule today with a meeting with the President. We just couldn't change that.

We are running short of time again. Your entire statements will be submitted into the record and will appear as part of the permanent hearing record.[1] [2] I would like you both to summarize your statements. If I have any questions, we will proceed. If you would like to go first and identify yourself, that would be fine.

Mr. HARRISON. Thank you, Mr. Chairman.

I am Joseph H. Harrison, Jr., Vice President and General Counsel of National Futures Association. With me are Daniel Driscoll and Douglas Campbell, NFA Director of Investigations. Mr. Driscoll is NFA Vice President for Compliance.

I have a few brief remarks.

Senator RUDMAN. The entire statement will be included in the record.

Mr. HARRISON. We are happy to come before you today on behalf of the new self-regulatory organization for the futures industry. NFA exists because Congress believed in the premise of self-regulation and the promise of NFA.

Aware of this congressional confidence, NFA has become in less than 18 months an important regulatory force in the futures industry. The futures industry itself is committed to the fight against boilerroom and other unethical sales practices. To wage this battle, the industry has armed NFA with effective regulatory weapons.

The linchpin is uniform required membership in NFA. Under the Commodity Exchange Act, CFTC and NFA rules provide that NFA members may deal with CFTC registrants, other than floor brokers, only if they are also NFA members. Since futures transactions must be ultimately handled by an NFA member, these rules assure the public that transactions conducted on the licensed futures exchange are only handled by persons within NFA jurisdiction.

NFA is equipped to prevent wrongdoing or detect and punish wrongdoing among its members. We have taken a number of actions to do so. Where it has been necessary to call on the additional power of the courts to issue an injunction or appoint a receiver or freeze assets, the CFTC has mobilized its forces and worked hand-in-hand with NFA to get that done.

Unfortunately, as you discussed here, the lure of the quick money to be made from the mooches, as the crooks often call their customers, will continue to draw the unscrupulous people into these kinds of schemes. And these schemes, although they lurk outside the structure of CFTC regulation and self-regulatory control, cast a shadow over the futures industry. NFA is concerned about them.

NFA firmly believes that State and local enforcement authorities really need only encouragement and cooperation to be positioned on the front line in this battle. And the open season provision, as you have noted, enables them to do that.

Fraud is, of course, illegal in every State, but States clearly need special tools to enable them to focus and speed enforcement powers. For instance, just an example, few, if any, States have a law that makes it per se illegal under State law to act in a way that requires the CFTC registration and not have a CFTC registration. States need the flexibility of these kinds of laws to allow them to act in those cases without having to amass complicated proof of actual fraud.

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[1] See p. 223 for the prepared statement of Joseph H. Harrison, Jr.

[2] See p. 229 for the prepared statement of Luis Vigdor.

To fill that need, NFA and CFTC have pooled their resources and expertise with North American Securities Administrators in a working group to draft model State law. This working group is chaired by Chris Anderson of the State of Florida who testified before the subcommittee on Monday.

The model State code will put flesh on the bones of open season and allow the States to stand shoulder to shoulder with NFA and CFTC in an effort to eliminate regulatory safe havens. In the meantime, NFA is working to allow existing laws to be brought to bear on these people who defraud the public.

NFA, under Mr. Campbell's direction, regularly reviews newspapers and periodicals for suspicious advertising, especially want ads for telephone salesmen. We relay that information to the appropriate State and the CFTC. In addition, we hear customer complaints and tips from NFA members, people in the futures industry, who are often the first persons to spot a boilerroom in their own locale. NFA attempts to put the right authorities on these problems.

So far NFA has made over 35 referrals to the CFTC and the various States. These have resulted in a number of enforcement investigations and actions by the CFTC and the States, including the States of Pennsylvania, Arizona, Florida, Washington, and California.

NFA has also joined with the States and the CFTC in a number of other cooperative efforts which are detailed in my prepared remarks.

Finally, NFA understands that the smooth, strong-willed boilerroom salesman will never be truly defeated unless the public, his target, is adequately armed in self-defense. The salesman attacks with questions, all of which have only yes answers and all of which lead to the final yes, I will send the check. He doesn't want to answer questions, he only wants to ask them.

The customer needs to be armed with the questions that will distinguish the illegitimate solicitors from the legitimate solicitors. To that end, NFA is preparing a leaflet for general distribution entitled "Before You Say Yes—15 Questions to Turn Off a Swindler." NFA intends to give that leaflet the widest possible circulation.

This leaflet, by the way, addresses the question that Senator Nunn asked this morning. And when the leaflet is produced—it is in the final stages of production now—we would be happy to forward copies to the subcommittee for inclusion in the record or for informational purposes.

In addition, NFA is cooperating with NASAA's Public Awareness Committee to produce an investor alert to be published in conjunction with the Council of Better Business Bureaus. NFA hopes by these and other methods to better arm the public to defend themselves against these swindlers.

Thank you.

Senator **Rudman**. Thank you very much.

I just want to comment, we are very pleased with what you are doing. We are very familiar with one of your associates who served, I believe, to help the subcommittee at some time after working with CFTC, or while working with CFTC.

I agree with you completely, that your people in the field, for instance your members in Miami and Los Angeles and New York, are probably going to spot these long before Federal authorities will. To the extent you bring these to the attention of Federal and State authorities, it is extremely important. Probably one of the most important things we can do is to get these people and nip it in the bud, if you will.

Thank you very much.

Mr. Vigdor, if you would summarize your statement, we would appreciate it.

Mr. VIGDOR. I will.

My name is Luis Vigdor. I appear today in the capacity of chairman of ICTA, which is the Industry Council for Tangible Assets.

Senator RUDMAN. If you could pull the microphone a little closer, I think we could hear you. It is a bad room for acoustics.

Mr. VIGDOR. ITCA is a trade organization. We represent dealers, coin dealers and institutions who are actually actively engaged in the buying and selling of precious metals and numismatics in this country.

We have an office with a full staff in Washington. With me here is Donald C. Evans, who is supervising the operation here in Washington.

We were founded in 1983, with the purpose of representing our industry here in Washington and also to look for better ways of protecting the public and to protect our customers, because we have seen certain developments, as you have mentioned before, that failures have caused massive losses among the public.

As a whole, our industry is a cleancut industry. We have isolated cases where you have the boilerroom-type operations who pop up from nowhere and use massive advertising to lure the customers, to create a sense of security.

If, for instance, a certain company comes up and starts advertising with full pages in the Wall Street Journal on a continuous basis and publishes pictures of three buildings where they occupy one or two floors, they create a complete wrong sense of security. It is almost a quasi-endorsement of this publication. Then, after the salesman calls and the salesman says have you heard about us; of course, I have seen the ads in the Wall Street Journal, or other publications.

We feel that the main problem we have is; No. 1, to tackle the advertising. The advertising has been, in my opinion, the main culprit in creating these massive losses because in a certain way it endorsed part of these fraudulent schemes which went on.

ICTA has given the highest priority to these projects. We feel that we must protect the public and we feel that we have to, and we are trying to, develop an insurance program which will insure the delivery of the goods being purchased by the public. This is the type of insurance which will be implemented at the inception of the transaction.

We are working with this and we are not quite finished. We have one of the large insurance brokerage houses in this country investigating this very seriously. We hope we will be successful with that.

We are also trying to institute education, education to the public, so the public is aware as to what is going on. How come that a company is all of a sudden advertising metal at a price which is impossible to sell? I mean it; I work too long in this industry, I put in 12 hours a day in gold and silver selling, and when I saw these ads appearing every single day, I was smelling a rat and I knew exactly this cannot last too long, that the public funds were being used for something else but buying the gold and securing these transactions. You cannot sell a dollar for ninety-five cents. It is as simple as that.

So I feel that if we educate, No. 1, the press about what type of ads they can accept, and pressure them to come and consult with some agency, or maybe with our industry, if they--the advertiser—are legitimate. No. 2, educate the public. I think we can solve the problem right there.

I don't feel, contrary to some of the opinions here, that Government regulation is going to solve our problem. I think that the Industry Council, ICTA, can do much more for the investor by utilizing our expertise and our knowledge and our resources in Washington to promulgate the information about investment in gold and silver.

I must say this: The industry is quite large, but the great majority of the people who work out there are honest working people who make a living on a day-to-day basis. Most of them deliver and deliver the material upon receipt of the funds. They do not sell delayed delivery plans. They do not send you a dividend check in order to maintain your gold for another 2 or 3 months and promise you to give you 2 percent a month in order for them to hold onto your gold.

So I feel that ICTA has a very good opportunity to work with Government agencies in this particular case, and can give you some real good information about how to solve it. We have some pretty good ideas about that.

Senator RUDMAN. Thank you very much. I agree with you completely. I would say the same thing that I have said to the prior witness. Obviously, when you see these things in this industry, and I am familiar with your company, staff has given me a copy of some of the ads that your company publishes, you are in a better position probably than anyone to understand these fraudulent operations, if they go public and they advertise. And certainly I think the industry is a major part of the effort here in trying not to regulate but to prosecute those that ought to be prosecuted.

Mr. VIGDOR. Could I mention something? About 1 year before IGBE went under, there was a massive article in Forbes magazine. I was interviewed and in my interview I said "I have no idea how these people make the money because there is no way you can sell gold on a future delivery basis and actually sell it under the actual going price of the krugerrand at that particular time without covering. If you had to cover that sale to insure your customer was protected at that price of gold, there was no way you could sell it and make a profit." So it was obvious to me the funds coming in—I am talking about IGBE in this particular case—were being used for something else and definitely not to buy the gold. They were banking on the price of gold to go down. So when the price of gold went down, and maybe 3 months after they had to make a delivery, they would now cover at much lower prices and hopefully deliver to the customers. They still attempted not to deliver by sending checks out to the customer saying, "If you accept this particular check as an interest payment for the gold which is sitting over here, we will hold the gold for another 2 months." But the moment the price went up, the moment the price started to run away from $300 all the way up to $500, I knew as a trader that they were dead. I was just totally helpless there because I knew they were going down the drain because that gold which had sold at $300 was costing them now $500 to cover.

Senator **Rudman**. We thank you for your testimony. I just want to make a couple of closing points, one that I think would be of some interest.

We convened these hearings in the hope of educating the public as to the risks that some are taking, exploring what gaps there are in Federal agency regulations. We still see reluctance, a genuine, well-intentioned reluctance on the part of any single Federal agency to take on this responsibility. It is clearly a multiagency responsibility. We are not sure whether or not legislation is going to help, but we are going to look at it.

We are mindful that regulation for regulation sake will not solve the problem. We are also going to proceed informally by putting some people together to see if we can find better ways of enforcing these laws.

I do want to state that we are very encouraged by a letter which we received today from the Director of the FBI, Director Webster.

[The letter referred to was marked "Exhibit No. 10," for reference, and follows:]

Exhibit No. 10

U.S. Department of Justice,
Federal Bureau of Investigation,
Washington, D.C., March 16, 1984.

Hon. Warren B. Rudman,
Vice Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, Washington, D.C.

Dear Senator Rudman: This letter is in response to your request of March 7, 1984, for a written statement from me addressing certain issues of immediate interest to the Permanent Subcommittee on Investigations in connection with the Subcommittee's inquiry into precious metals fraud investigations. I will address each of these issues in the paragraphs that follow:

Issue 1. How much of the Bureau's resources are and have been committed to precious metals fraud investigations during the past two years?

Response. Precious metals fraud investigations are generally conducted pursuant to the FBI's jurisidiction under the Fraud by Wire Statute (18 USC 1343). Statistics maintained by the FBI with respect to this area are not broken down in terms of the particular merchandise or service being peddled. Accordingly, no statistics that specifically address this question are available.

Issue 2. What is the current status of the Bureau's investigations of Bullion Reserve Corporation of North America (BRNA) and Universal Precious Metals, Inc. (UPMI)?

Response. The FBI's investigations of alleged criminal activity involving the above enterprises are currently ongoing; and hence, I am not able to comment in detail. However, I can provide the following:

BRNA

At the present our investigation of BRNA is focusing on the tracing of investor funds allegedly misapplied or misappropriated by the former chairman of BRNA. Additionally, the FBI is investigating allegations that other officers and employees of BRNA may have been involved in fraudulent activity. To date, numerous individuals have been interviewed and a large number of records examined. Our investigation is taking place in conjunction with that of the Los Angeles County District Attorney's Office.

UPMI

The FBI's investigation to date has resulted in the execution of a search warrant at UPMI's premises in September, 1982, at Fort Lauderdale, Florida, and the seizure of over 4,600 pounds of records. The principal defendants have filed a motion pursuant to Rule 41(e) of the Federal Rules of Criminal Procedure for return of the seized records, and the District Court currently has this matter under consideration. If the Court denies defendents' motion, I anticipate that bills of indictment charging Fraud by Wire and Mail Fraud will be presented to the Federal grand jury in Chicago, Illinois, within several months following such a decision.

Issue 3. What is the participation of the Miami Office of the FBI in enforcement efforts aimed at fraudulent boiler room activities in general and at fraudulent activities of precious metals dealers, in particular, in the South Florida area? Are these enforcement efforts being carried our sufficiently to protect the investing public?

Response. The Miami Office of the FBI estimates that over 50 boiler room operations suspected of fraudently peddling such diverse products as collectables, strategic metals, and office equipment, are in business in the Miami area at any one time. At present we have a number of these enterprises, as well as several that are now defunct, under investigation. At least 12 of these boiler rooms under investigation have been, or are currently involved in the alleged fraudulent sale of precious metal commodities or gold and silver coins. To date, the Miami Office has obtained a number of indictments charging both principals and salesmen with Fraud by Wire and Mail Fraud and more are expected.

Our Miami Office if fully cognizant of the fact that boiler room enforcement is a major problem in South Florida. Accordingly, Miami is aggressively pursuing imaginative investigative measures within the bounds of the law and existing investigative guidelines to put these enterprises out of business and to obtain convictions of both principals and salesmen engaging in Interstate Wire Fraud. Miami has stepped up cooperative enforcement activities with Federal and Florida law enforcement and regulatory agencies as well as Federal and State of Florida prosecutors. The Miami Office recently joined the U.S. Postal Inspection Service and the Office of the Inspector General of the U.S. Department of the Interior in a major coordinated crackdown on boiler rooms allegedly engaged in fraudulent misrepresentations of investment opportunities in mineral rights leases of land managed by the Bureau of Land Mangement.

Notwithstanding our efforts in combating boiler room related fraud in the Miami area, it must be pointed out that the FBI is limited in its ability to prevent the investing public from falling prey to unscrupulous boiler room sales activities. Our investigative authority in this area is not triggered until such time as information is developed that persons are engaged in, or are conspiring to engage in, violations of Federal law. More often than not, this information is not ascertainable until after losses have been incurred by the public and resulting complaints are received by the authorities. This is so because boiler room operators are becoming increasingly sophisticated in the use of methods to avoid early detection. For example, sales representations are frequently couched in terms that allude to a return on investment sometime in the future—long after the conman has shut down his operation, absconded with the unsuspecting investor's money, and set up business elsewhere, and long before the investor becomes aware that he has been defrauded. Consequently, the FBI's enforcement activities are often "after the fact." We are continuing to explore methods whereby the FBI, in cooperation with other Federal and state agencies, not only in South Florida, but on a national level, can put a stop to this type of consumer fraud before significant financial losses are incurred.

Issue 4. Is the Miami Office of the FBI planning to disband its Fraud Unit?

Response. Currently the Miami Office has three squads devoted to the investigation of white-collar crime matters. These investigations encompass, *inter alia,* Fraud by Wire, Public Corruption, Bank Fraud and Embezzlement and Fraud Against the Government matters. The Special Agent in Charge has recently approved a supervisory realignment of these squads to take place shortly, that is designed to more effectively address pressing needs in the areas of Public Corruption and Fraud Against the Government. The Special Agent in Charge does not anticipate that this reorganization will materially decrease investigative assets currently devoted to Fraud by Wire matters.

Issue 5. Would the Bureau be willing to dedicate Agents to participate in an interagency task force dealing with precious metals, oil and gas and other boiler room firms currently doing business in South Florida and Southern California if such a task force were to be formed?

Response. As mentioned above, our Miami Office is already participating in a cooperative effort with other Federal and state agencies with enforcement responsibilities in the boiler room fraud area. On March 6, 1984, the FBI joined with the U.S. Postal Inspection Service and the Office of the Inspector General, U.S. Department of the Interior (with prosecutive support from the Department of Justice and the U.S. Attorney's Office) in the execution of search warrants directed at firms allegedly involved in boiler room sales of fraudulently misrepresented investment opportunities in land managed by the Bureau of Land Management. (This enforcement activity in the Miami area was part of a nationwide coordinated approach by the above agencies. To date, this approach has achieved notable results and participating agencies are studying ways in which this approach can be utilized to address boiler room enterprises engaged in other fraudulent schemes).

Our Miami Office will join with other Federal and state law enforcement and regulatory agencies in the latter part of March, 1984, to formulate plans designed to enhance early detection of fraudulent boiler room operations, minimize losses to consumers and secure subsequent prosecution of wrongdoers. Our Los Angeles Office is currently working closely with the Los Angeles County Sheriff's Department, the Los Angeles County District Attorney's Office, the Commodity Futures Trading Commission and the U.S. Postal Inspection Service in a number of boiler room investigations and is studying the feasibility of an enforcement approach similar to that underway in Miami.

In conclusion, it is my judgment that continued and expanded cooperative enforcement efforts by Federal and state authorities, coupled with increased consumer awareness, are the keys to successful deterence and prosecution of boiler room operators engaged in defrauding the public.

Sincerely yours,

WILLIAM H. WEBSTER, *Director.*

Senator RUDMAN. Mr. Webster is going to meet later this month with a wide range of State and Federal agencies to formulate plans designed to break up the boilerrooms. I think to bring the weight of the FBI against this very serious problem and put them in direct touch with those they work with, the appropriate U.S. attorneys in the various jurisdictions around the country, is a very important step.

We will be announcing the results of further inquiries we will be making both of Director Webster and of the other agencies. We will be convening some people to look into ways that we can put together an interagency-State-Federal task force to informally, in an unstructured way, start discussing some other ways, aside from legislation, that might be of help. We are doing this because, frankly, we don't see anybody else taking leadership in this area. We think the subcommittee has a continuing interest in it.

Thank you very much.

Mr. HARRISON. Just one point. We have discussed with the FBI assisting in training their people in spotting commodity-related frauds.

Senator RUDMAN. I am sure if we do this on a continuing basis we will probably be able to start cutting down the number of these outfits that are starting up.

Thank you for being here.

The subcommittee will now stand in recess until the call of the chairman.

[Senator present at time of recess: Senator Rudman.]

[Whereupon, at 4:06 p.m., the subcommittee was recessed, to reconvene subject to the call of the Chair.]

APPENDIX

PREPARED STATEMENT OF SENATOR SAM NUNN

FOR THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

COMMODITY INVESTMENT FRAUD II

MARCH 21, 1984

Mr. Chairman, I am pleased to be here today to participate in these hearings which will again register this Subcommittee's continuing concern over the widespread problem of commodity investment fraud. We have, in the past, examined in detail allegations of criminal activity in the commodity investment field. Following approximately an eight-month investigation by the Subcommittee staff, in February, 1982, we held public hearings on this issue. As a result of those hearings, you introduced legislation, which I cosponsored, portions of which were later enacted into law as the Futures Trading Act of 1982. That legislation was a well-reasoned and realistic response to some of the jurisdictional problems that we had uncovered in our prior hearings. I congratulate you, Mr. Chairman, and the Majority staff, for your fine work in today continuing this Subcommittee's investigative work in the field of commodity fraud.

Unfortunately, as your investigation and the first day's hearings have shown, this problem has not gone away. In the last few years, precious metals fraud has become a "growth industry", costing the public millions of dollars. The collapse of several large precious metals trading companies graphically illustrates the abuses in this field and the continuing victimization of unwary investors across the country. Hundreds of millions of dollars have been defrauded and tens of thousands of citizens victimized by an unscrupulous cadre of fast-talking, high-living swindlers. Commodity fraud has become the "Ponzi" scheme of the 1980's, with the con man robbing from one investor to placate another while he amasses a tidy fortune from his poor victims.

In focusing our attention on yet another facet of this critical problem, today's hearings will examine the federal as well as the industry's response to this problem. I am anxious to learn why it appears these criminals can operate with almost absolute immunity from federal regulatory and law enforcement agencies. I am equally concerned about the preliminary findings of the Subcommittee staff that tend to indicate that such criminal activity is not a priority of our federal government.

As is obvious from the Subcommittee's work over the past few years -- including hearings on narcotics trafficking, offshore banking, and labor racketeering -- the Chairman and I share deep concern over the threat which criminal activity, in all its forms, continues to pose in these United States. In examining the subject of organized criminal activity, and I may add it is quite apparent from the work done by the Subcommittee staff in the first day's hearings that we are talking about organized criminal activity in the commodity fraud field, this Subcommittee has always sought not only to create a public awareness of the problem, but also to insure, through legislative as well as agency action, greater cooperation and effectiveness among our various law enforcement agencies. All of the witness that we will hear from this week will, I believe, underscore the fact that such cooperation and effectiveness is especially needed in this complex commodity field. State and federal, regulatory and prosecutive, judicial as well as legislative, we all must work together to end this growing problem. It is with these thoughts in mind that I eagerly await today's testimony and the evidence that will soon be revealed in this public hearing.

Again, I congratulate you, Mr. Chairman, as well as the Majority staff including Chief Counsel Cass Weiland and Assistant Counsel Carol Fox for your excellent work in preparation for these hearings. Certainly this is an area which is deserving of the Subcommittee's continuing attention and concern. It follows in the best tradition of this Subcommittee's investigative responsibilities.

PREPARED

STATEMENT

OF

E. C. (CHRIS) ANDERSON
DIRECTOR OF SECURITIES
DEPARTMENT OF BANKING AND FINANCE
OFFICE OF COMPTROLLER
AND
CHAIRMAN, COMMODITIES COMMITTEE
REGULATORY LIAISON SECTION
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

TO THE

UNITED STATES SENATE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
SENATE PERMANENT SUBCOMMITTEE
ON INVESTIGATIONS

WASHINGTON, D.C.
MARCH 19, 1984

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, I AM PLEASED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE YOU AS A REPRESENTATIVE OF FLORIDA'S COMPTROLLER, GERALD LEWIS, DEPARTMENT OF BANKING AND FINANCE. BY WAY OF INTRODUCTION, I AM THE DIRECTOR OF THE SECURITIES DIVISION FOR THE DEPARTMENT. WITH ME IS LARRY FUCHS, CHIEF OF INVESTIGATIONS FOR OUR DEPARTMENT. I HAVE BEEN

INVOLVED IN SECURITIES INVESTIGATIONS AND THE ADMINISTRATION OF FLORIDA'S SECURITIES ACT FOR SEVEN YEARS - THREE OF THOSE YEARS FROM AN INVESTIGATIVE STANDPOINT AND THE REMAINDER AS AN ADMINISTRATOR AND REGULATOR. CURRENTLY, I AM THE CHAIRMAN OF THE COMMODITIES COMMITTEE OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. (NASAA) AND HAVE RECENTLY BEEN APPOINTED TO THE ADVISORY COMMITTEE ON CFTC-STATE COOPERATION BY THE COMMODITY FUTURES TRADING COMMISSION. I AM HERE PRIMARILY AS A REPRESENTATIVE OF MY DEPARTMENT, BUT I AM ALSO WILLING TO ANSWER GENERAL QUESTIONS REGARDING NASAA'S POSITION RELATING TO COMMODITIES, BOILER ROOMS AND PRECIOUS METALS ACTIVITIES.

THE OPERATION OF FRAUDULENT PRECIOUS METALS BOILER ROOMS AND OTHER INVESTMENT FRAUD SCHEMES IS NOT LIMITED TO FLORIDA ALONE. HOWEVER, FLORIDA UNFORTUNATELY HAS GAINED AN UNWANTED REPUTATION AS THE CON MAN'S CAPITAL OF THE WORLD. MIAMI'S BISCAYNE BOULEVARD IS COMMONLY REFERRED TO AS "MAGGOT MILE" AND THE NUMBER OF BOILER ROOM SCHEMES CROPPING UP IN THE MIAMI/FT. LAUDERDALE AREA ON AN ALMOST DAILY BASIS IS PARTICULARLY ALARMING.

FLORIDA HAS LONG HAD THE "GLORY" OF BEING KNOWN AS A STATE WHERE, LIKE IT OR NOT, WHITE COLLAR CRIME PROLIFERATES. THE LAND FRAUDS OF THE 1920'S AND THE 1960'S, AND NOW THE COMMODITY AND ENERGY-RELATED FRAUDS, HAVE ALL SERIOUSLY TAINTED THE STATE'S "SUNSHINE" IMAGE. THE NATIONAL MEDIA HAS AGAIN FOCUSED ON FLORIDA'S SITUATION, CALLING FOR CORRECTIVE LEGISLATION. IN ADDITION TO THIS SUBCOMMITTEE'S INVESTIGATION, THE FLORIDA SENATE IS ALSO INVESTIGATING PRECIOUS METALS FRAUDS IN THE WAKE OF THE MULTIMILLION DOLLAR COLLAPSE OF INTERNATIONAL GOLD BULLION EXCHANGE AND SIMILAR INVESTMENT FRAUDS.

TYPICALLY, BOILER ROOM OPERATORS AND THEIR "PHONE JOCKEYS" HAVE CONCENTRATED ON PITCHING SALES TO THE UNSOPHISTICATED PUBLIC IN WHAT MAY BE TERMED "HOT" INVESTMENTS. THAT IS, INVESTMENTS THAT PEOPLE MAY KNOW ONLY A LITTLE ABOUT, BUT FOR

SOME STRANGE REASON THEY SEEM TO THINK THEY HAVE A GREATER POTENTIAL OF HIGHER RETURN ON THEM, SUCH AS GOLD AND SILVER OR OTHER PRECIOUS METALS, STRATEGIC METALS, PRECIOUS GEMS, COAL CONTRACTS, OIL AND GAS LEASES AND LOTTERIES AND LAND SALES. I THINK IT IS SAFE TO SAY THAT INVESTORS IN THESE SCHEMES TRULY BELIEVE THEY HAVE MADE WISE DECISIONS (DUE PERHAPS TO INFLATION) OR JUST THAT, DUE TO WHAT THEY'VE BEEN TOLD, THEIR "INVESTMENT" IS SAFER THAN OTHER, MORE TRADITIONAL INVESTMENTS. UNTIL RECENTLY, WHATEVER WAS IN VOGUE AT THE TIME APPEARED TO BE THE GENERAL LIMITATION OF WHAT THE MAJORITY OF BOILER ROOMS WERE OFFERING, THAT IS, MOST OF THEM WOULD BE HAWKING THE SAME ITEM.

HOWEVER, OF LATE, OUR OFFICE HAS NOTED THAT BOILER ROOMS IN FLORIDA HAVE PROLIFERATED TO SUCH A DEGREE THAT A "PHONE JOCKEY" HAS A VERITABLE SMORGASBOARD OF INVESTMENT SCAMS FROM WHICH TO CHOOSE IN SELLING. CURRENTLY POPULAR ARE (1) PRECIOUS METALS (GOLD AND SILVER), (2) PRECIOUS GEMS, AND (3) SPINOFFS OF THE FEDERAL BUREAU OF LAND MANAGEMENT'S OIL AND GAS LEASE LOTTERY PROGRAM. TOMORROW, BOILER ROOM OPERATORS MAY BE SELLING A NEW STRATEGIC METAL, JUST DISCOVERED AND CRITICAL TO THE COUNTRY'S DEFENSE SYSTEM OR SOMETHING EQUALLY EXOTIC.

SINCE OCTOBER, 1983, OUR DEPARTMENT HAS FILED ACTIONS AGAINST 77 DIFFERENT BOILER ROOM COMPANIES. THE MAJORITY OF THESE HAVE INVOLVED THE SALE IN ONE FASHION OR ANOTHER OF THE FEDERAL OIL AND GAS LEASE LOTTERY PROGRAM THROUGH FRAUDULENT MEANS. IN AN EFFORT TO MORE QUICKLY PUT THEM OUT OF BUSINESS WE HAVE FILED THESE ACTIONS AS IMMEDIATE FINAL CEASE AND DESIST ORDERS, WHICH HAVE THE EFFECT OF SHUTTING DOWN A FIRM'S FRAUDULENT OFFERINGS UPON THE FILING OF OUR ACTION. OUR DEPARTMENT HAS FOUND THIS ADMINISTRATIVE PROCESS TO BE MUCH MORE EFFICIENT THAN ATTEMPTING TO OBTAIN TEMPORARY RESTRAINING ORDERS OR PRELIMINARY INJUNCTIONS WHEN IT IS NECESSARY TO ACT VERY QUICKLY IN ORDER TO PROTECT THE INVESTING PUBLIC.

TO SAY THAT BOILER ROOM ACTIVITY IN FLORIDA IS A PROBLEM IS AN UNDERSTATEMENT. I HAVE EVEN SEEN TELEVISION DETECTIVE PROGRAMS WHOSE PLOTS CENTER AROUND A FRAUDULENT GOLD BULLION

OPERATION. ONE CERTAINLY MUST AGREE THAT WHEN HOLLYWOOD SCREEN WRITERS RECOGNIZE BOILER ROOM AND PRECIOUS METALS ACTIVITY AS SOMETHING "WORTHY" FOR TELEVISION, IT IS AN INDICATION OF A NATIONAL PROBLEM TO WHICH ANYONE CAN RELATE!

AN IMPORTANT POINT TO NOTE THAT WE HAVE DISCOVERED IN FLORIDA IS THAT VERY SELDOM DOES A BOILER ROOM SOLICIT INVESTORS IN THE STATE FROM WHICH THEY OPERATE. THE OPERATORS AND PRINCIPALS OF THESE COMPANIES CLEARLY DO THIS IN ORDER TO AVOID DETECTION OF THEIR OPERATIONS BY LOCAL AND STATE AGENCIES - UNFORTUNATELY, THIS METHOD OF OPERATION OFTEN WORKS AND WE BECOME AWARE OF THEIR ACTIVITY AFTER THEY'VE CLOSED SHOP AND SET UP ANOTHER BOILER ROOM OPERATION UNDER A DIFFERENT NAME DOWN THE STREET. CURRENTLY, OUR DEPARTMENT IS CONDUCTING INVESTIGATIONS ON 70 DIFFERENT BOILER ROOMS, APPROXIMATELY THREE-FOURTHS OF WHICH INVOLVE THE SALE OF OFF-EXCHANGE COMMODITIES AND PRECIOUS METALS, PARTICULARLY IN THE MIAMI/FT. LAUDERDALE AREA; BUT WE HAVE ALSO SEEN THEM MOVING TO OTHER LOCALES THAT WE WOULD NOT CONSIDER TO BE TYPICALLY "SOUTH FLORIDA." ONE WONDERS WHAT MOTIVATION THERE IS TO MOVE AWAY FROM FLORIDA'S GOLD COAST WITH ITS EASY ACCESS TO OFFSHORE BANKS, MILD CLIMATE, AND "LIFE IN THE FAST LANE" QUALITIES, BUT IT CERTAINLY DOES SEEM TO BE A GROWING TREND.

IN ORDER TO COMBAT PRECIOUS METALS AND BOILER ROOM FRAUD, WE HAVE ESTABLISHED A SPECIAL TASK FORCE WITHIN OUR DEPARTMENT TO HANDLE NOTHING BUT THESE TYPES OF INVESTIGATIONS. HOWEVER, THE PROBLEM IS SO VAST AND CONTINUES TO PROLIFERATE AT SUCH A RATE THAT ANY AGENCY INTERESTED (STATE OR FEDERAL) WOULD HAVE ITS HANDS FULL JUST TRYING TO INVESTIGATE THE WORST ONES. CONSEQUENTLY, WE HAVE RECENTLY PLANNED MEETINGS WITH ANY INTERESTED STATE OR FEDERAL AGENCIES IN ORDER TO "CUT UP THE PIE" AND ESTABLISH INVESTIGATIVE BOUNDARIES. WE FEEL THAT BY DIVIDING UP DIFFERENT INVESTIGATIONS ANY AGENCY WILL THEN BE ABLE TO MORE EASILY CONCENTRATE ON A PARTICULAR COMPANY, ITS PRINCIPALS OR THEIR ACTIVITIES. REGARDLESS OF WHO DOES WHAT AND WHEN FROM AN ENFORCEMENT STANDPOINT, WHAT IS IMPORTANT IS THAT SOMETHING BE DONE TO PUT A STOP TO THIS TYPE OF FRAUDULENT ACTIVITY.

To our knowledge, at the state level, our agency is the only one firmly committed to active pursuit of boiler rooms. Unfortunately, even our efforts are relatively small compared to the scope of the overall problem. Our department has a total of 27 investigators and 14 attorneys to handle all investigations and legal matters for the department which includes not only securities regulation, but regulation of state-chartered banks, savings and loan associations, finance companies, mortgage brokers and the accounting of all state monies! As noted earlier, our jurisdiction is only administrative and civil - we have no criminal authority whatsoever. However, in light of Florida's violent crime and drug trafficking problems, not to mention other, more mundane criminal matters, one can easily see that it is difficult to put prosecution of nonviolent economic crime at the top of the priority list. I cannot honestly say criminal prosecutors in Florida are not interested in pursuing fraudulent investment scams, it is simply a matter of allocation of resources to other, more significant matters.

Within the past two years, several noteworthy cases have been filed by our department involving precious metals, especially gold and silver investments. Perhaps the most significant case being against International Gold Bullion Exchange (IGBE). Our department filed an injunctive action against IGBE on April 13, 1983, after complaints had been received from investors of non-delivery of their gold when due and the failure to pay interest to them involving IGBE's deferred delivery program - which was initiated rather late during IGBE's lifetime as a measure of further delaying delivery of any gold whatsoever to investors. When our department became aware of this interest-paying program, we then believed we had enough evidence to constitute an investment contract under Florida law and filed our action. Shortly thereafter, the Florida Attorney General's office filed a separate action for a temporary injunction and the appointment of a receiver based on violations of Florida's Unfair and Deceptive Trade Practices Act. The courts granted the Attorney General's injunction and within approximately two weeks, IGBE had filed for reorganization under Chapter 11 of the

Bankruptcy Code - thus leaving the state, both our department and the Attorney General, without further means of pursuing the matter. The lowest estimates as to the loss of investor funds placed at IGBE is $90 million.

Shortly after IGBE collapsed, several new firms began to sell programs that seemed strikingly similar to those of IGBE. On October 5, 1983, our department filed Cease and Desist Orders against (1) American Gold Alliance, Inc., (2) Precious Metals Acquisitions, Inc., and (3) First International Metals, Inc. and their respective principals. All three companies we alleged were fraudulently selling unregistered securities (investment contracts) through unlicensed dealers and associated persons. Each of these respondents requested administrative hearings which are still pending at this time. Because these matters are still pending, I am not at liberty to discuss them further.

More recently, on October 19, 1983, our office issued a Cease and Desist Order against United Precious Metals, another boiler room operation selling fraudulent investment contracts. Oddly enough, the day after our Order was issued, UPM filed Chapter 11. As in the case of IGBE, our office was in the unfortunate position of not being able to do more, once that had occurred. Dollar losses involving UPM amounted to approximately $11 million, of which we are aware. Clearly, the ability of these companies to file for bankruptcy protection is a problem for Florida and any other state. Despite the fact that our office may be able to get a Receiver appointed and distribute remaining assets to investors in any particular matter, it does not preclude removal of the "problem" from the state level to the federal level - almost as if bankruptcy were planned by the promoters at the outset of their schemes.

HOWEVER, DETERMINING JURISDICTION IN THE AREA OF PRECIOUS METALS AND BOILER ROOM FRAUD IS PERHAPS THE MOST DIFFICULT HURDLE WE MUST OVERCOME. IN ORDER FOR OUR DEPARTMENT TO ACT, WE MUST DETERMINE THAT A SECURITY EXISTS. OFTEN THIS REQUIRES CREATIVE APPLICATION OF THE LAW, HOWEVER, WE FEEL, AS THE PRIMARY AGENCY IN FLORIDA CHARGED WITH PROTECTING INVESTORS, WE HAVE A STRONG MOTIVE TO DO JUST THAT. PRIOR TO ENACTMENT OF THE 1982 AMENDMENTS TO THE COMMODITY EXCHANGE ACT, WE WERE HESITANT TO FILE ANY ACTION THAT BORDERED ON BEING A COMMODITY - FORTUNATELY, THE CURRENT PROVISIONS OF THE ACT, PARTICULARLY RELATING TO OFF-EXCHANGE ACTIVITY HAVE ASSISTED AND COMFORTED US IN TAKING THE ACTIONS WE HAVE. HOWEVER, IT APPEARS THAT DESPITE EXISTING FLORIDA LAW AND THE 1982 AMENDMENTS TO THE CEA, PROMOTERS ARE STILL ABLE TO DESIGN INVESTMENT SCHEMES THAT FALL BETWEEN THE CRACKS OF EXISTING REGULATION. UNTIL SOMETHING IS DONE TO FILL THESE CRACKS, BOILER ROOMS OF ALL TYPES WILL CONTINUE TO FLOURISH.

DUE TO THE WIDESPREAD ACTIVITY OF BOILER ROOMS IN FLORIDA, WE OFTEN RECEIVE INQUIRIES FROM FEDERAL AGENCIES AS TO THE EXTENT OF ACTIVITY OF A PARTICULAR COMPANY OR INDIVIDUAL IN FLORIDA OR WE RECEIVE REFERRALS FROM FEDERAL AGENCIES. WITHIN THE PAST TWO YEARS, THE CFTC PARTICULARLY HAS BEEN VERY COOPERATIVE WITH FLORIDA AND MANY OTHER STATES. THE 1982 AMENDMENTS TO THE CEA OBVIOUSLY OPENED THE DOOR FOR MUCH OF THIS COOPERATION AND IT DOES SEEM SINCERE AND BONA FIDE - PARTICULARLY IN THE AREAS OF TECHNICAL ASSISTANCE, EXPERT TESTIMONY, AND EXCHANGE OF INFORMATION BETWEEN AGENCIES. THIS IS NOT TO SAY THAT EVERYTHING IS TO FLORIDA'S OR ANY OTHER STATE'S LIKING THOUGH. I AM REFERRING PARTICULARLY TO THE CFTC'S RECENT PROMULGATION OF RULES RELATING TO LEVERAGE CONTRACTS AND FIRMS OFFERING THESE CONTRACTS. AS I UNDERSTAND, THE CFTC HAS DETERMINED THAT LEVERAGE CONTRACTS TEN YEARS OR LONGER WILL COME WITHIN THEIR JURISDICTION AND ANYTHING LESS THAN TEN YEARS WILL FALL TO STATE JURISDICTION AS "OFF-EXCHANGE ACTIVITY." I APPRECIATE THE FACT

THAT THE CFTC MUST DRAW THE LINE AT SOME POINT, BUT THE FACT REMAINS THE VAST MAJORITY OF COMPANIES OFFERING LEVERAGE CONTRACTS ACROSS THE COUNTRY WOULD NOT COME WITHIN THE CFTC'S JURISDICTION, THEREBY LEAVING JURISDICTION TO THE STATES. BECAUSE OF THIS, THE NASAA COMMODITIES COMMITTEE, WHICH I CHAIR, THE CFTC, AND THE NATIONAL FUTURES ASSOCIATION ARE CURRENTLY WORKING ON A MODEL STATE ACT AIMED SPECIFICALLY AT FILLING THE CRACK BETWEEN FEDERAL AND STATE JURISDICTION IN THIS AREA. ON THE WHOLE THOUGH, THE EXPERIENCE FLORIDA HAS HAD WITH THE CFTC HAS BEEN VERY GOOD.

FLORIDA'S EXPERIENCE WITH THE SEC HAS BEEN PARTICULARLY GOOD AT THE LOCAL LEVEL WITH THEIR BRANCH OFFICE IN MIAMI. BEYOND THAT IT IS DIFFICULT TO VOICE ANY OPINION OTHER THAN TO SAY BETTER COOPERATION AND WORKING RELATIONSHIPS WITH THE STATES WERE ADDRESSED AT A CONFERENCE HELD LAST FALL BY THE SEC, WHICH I ATTENDED. FROM AN ENFORCEMENT PERSPECTIVE, HOWEVER, THE SEC HAS CONCENTRATED ON MARKET MANIPULATION, INSIDER ABUSE AND OTHER NATIONAL PROBLEMS THEY SEE WITHIN THE SECURITIES INDUSTRY. TRADITIONALLY, THE STATES HAVE HANDLED WHAT ARE TERMED MORE EXOTIC SECURITIES ENFORCEMENT MATTERS. CONSEQUENTLY, IN THE AREA OF BOILER ROOMS, PRECIOUS METALS FRAUD AND THE LIKE, IT IS MY VIEW THE SEC HAS TAKEN A CONSERVATIVE APPROACH AND DEFERRED TO THE STATES FOR APPROPRIATE ENFORCEMENT ACTIONS.

THE FEDERAL TRADE COMMISSION HAS JUST RECENTLY BECOME INTERESTED IN THIS AREA. WE HAVE PROVIDED THEM WITH SOME INFORMATION RELATING TO PRECIOUS METALS FIRMS IN FLORIDA AND ALSO ASSISTED IN CASES WE HAD AN INTEREST IN REGARDING THE OIL AND GAS LEASE PROGRAMS NOTED EARLIER. COOPERATION FROM THE FTC HAS BEEN RELATIVELY MINIMAL FROM OUR STANDPOINT ONLY BECAUSE WE WERE NOT FULLY AWARE THEY WERE INTERESTED IN THIS AREA.

All this leads me to conclude that many agencies, both state and federal, are interested in doing something to combat boiler room activity. Yet, I would further maintain that fraudulent activity of this nature is not limited exclusively to Florida. It is a nationwide problem that should also be dealt with on a national scale. Agencies, both federal and state should not bicker about jurisdiction or lack of it. While "discussions" like these are being conducted, citizens from across the country are being ripped off. By the time someone asserts jurisdiction, the promoter has closed one operation and started another new and different one - becoming richer from his ill-gotten gains all the while.

What we have done in Florida to combat boiler room operators, promoters, their salesmen and any other affiliates is to introduce legislation which essentially prohibits boiler room sales activity relating to any investment in anticipation of economic benefit. (See attached.)* Should this legislation pass, it will probably become effective sometime in June or July of this year. We are most anxious to rid Florida of fraudulent boiler room and precious metals activity.

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*House Bill 797.

PREPARED STATEMENT OF DORENE B. WOLF

SENIOR CORPORATIONS COUNSEL
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

MARCH 15, 1984

Mr. Chairman and members of this subcommitte, I am Dorene B. Wolf, an attorney at law admitted to practice in the State of California. I am presently a staff counsel with the Department of Corporations, State of California.

My responsibilities in connection with that agency are to enforce 13 laws contained in the Corporations Code, including the Corporate Securities Laws. My responsibilities in connection with the recently formed task force for the North American Securities Administrators Association is to act as lead counsel in the State of California in the prosecution of securities law violations in the sale of precious and strategic metals in California.

I wish to thank this committee for inviting me to appear before it and present the following information from California which the Department of Corporations believes will assist the subcommittee in its investigation.

1. The nature, extent and location of boiler room (high pressure telephone sales) activity, especially precious metals sales, in California today as compared to two years ago:

I am unable to make an accurate comparison to activities in California two years ago, as the Department of Corporations only became aware of the sale of leveraged commodities futures contracts in California in December, 1983.

Until December, 1983, the Department of Corporations was totally unaware of the abuses in this market. We had had only two or three isolated complaints from investors during all of 1982 and 1983. During the time Jerry Brown was Governor of the State of California, the Department of Corporations participated heavily in a trust deed task force. Because of this high priority established by the administration and the lack of investor complaints, nothing was done until December, 1983 when NASAA requested our involvement and apprised us of the names and locations of certain dealers in California.

The matters of Bullion Reserve and International Gold Bullion Exchange were not within our jurisdiction because both companies appeared to be cash and carry gold dealerships.

A. Nature: The activities which we are currently investigating, however, involve various transactions concerning precious metals such as, gold, silver and platinum as well as coins. Strategic and exotic metals such as, cobalt, cadmium, cromium, silicon, mercury, etc. are being sold on a much smaller scale as they do not have the same appeal to investors as do the precious metals and coins.

My investigation, begun in mid February, 1984, reveals that many investors do not understand what they are purchasing or they believe they are purchasing precious metals for future delivery. They are told that they can make a percentage down payment on the metal and carry the balance on margin for a certain period of time. If the price of gold goes up, they can sell before taking delivery or roll their contracts over into another contract. If the price goes down the company calls them for margin. Many of these investors believe that because they are paying interest on the margin account the company has purchased the gold on their behalf and is holding it until fully paid for. In most cases, this is patently untrue as the dealer has not purchased the metal at all. Instead, in many instances, the dealer has pooled the investor's down payment with other investor money and uses this money to purchase itself a futures contract in its own name. In many instances, the company has used the investor's money for operating expenses, automobiles, airplanes, and other personal luxuries. In one instance, the commissions paid to salesman were greater than the commissions charged on the transaction.

Investor complaints are that salesmen have called them several times using high pressure tactics to induce them into buying metal, telling them that the price of the metal is going up, and that they must get in right away. Many have requested time to give it some thought and have been called back stating that the trade was made in their names and the commodity has gone down in price and that they owe money for margin. A part of this high pressure sales campaign includes the company's not being available to liquidate a client's account when the price of the metal goes up. I have inside information that when the price of the metal goes up many of the companies put their telephones on hold to create busy signals; investors are told that their broker is no longer with that company and then the investor is told that he will be called back by someone else but never is. In some instances, the investor who usually is calling long distance is put on hold while his broker is being called, and left there until he has to call back at which time the process is repeated.

B. Extent: At this time I have knowledge of approximately 20 to 25 dealers, one of which admits to $10,000,000 gross a month.

C. Location of boiler rooms: Approximately 20 dealers are operating in the Orange County area. Most of these are located in Tustin, Newport Beach and Huntington Beach, and El Toro, California. I am aware of two dealers operating in the Los Angeles area. Both of these are strategic or exotic metals dealers.

2. Specific programs implemented by our offices to combat precious metals fraud:

In December, 1983, the Department of Corporations, combined forces with other states securities agences under the auspices of the North American Securities Administrators Association to form a multi-state task force. Those on the task force have provided their time and expertise in aiding one another in the prosecution of securities violations in connection with precious metals sales. The Commodities Futures Trading Commission has provided a two-day seminar attended by various state and federal agencies to educate us in methods of prosecutions and investigations.

3. The extent of the state's resources which are and have been committed to precious metals fraud investigations and enforcement actions during the past two years:

During the past two years, there has been no commitment to precious metals fraud and investigations as the Department of Corporations was unaware of the abuses at that time. In 1984 however, we have committed two line counsel, one accountant and one investigator from our staff to this project. In addition, as demand arises, the Department of Corporations has committed itself to mobilization of the entire Los Angeles Enforcement Division.

4. Description of civil and criminal actions brought by your office in 1982 and 1983 and the precious metals fraud area:

There were no civil or criminal actions brought by the Department of Corporations in 1982 and 1983. As you are now aware, these abuses did not come to our attention until late 1983.

5. General description of our current investigations regarding precious metals and other investment-type sales:

During 1984, I have issued subpena duces tecum for records to approximately 18 precious metals dealers. Following service of the subpenas five precious metals dealers have closed their doors for business; two have fully complied with the subpena duces tecum and records are now being reviewed; four have only partially complied with the subpena duces tecum; and seven have refused to comply at all. I am initiating 11 subpena compliance actions for filing in State court.

California investors are being interviewed. Insiders, such as, salespersons and other personnel have come forward and are being interviewed.

One dealer closed its doors and fled to Canada. Through our efforts they have been closed down there, certain personal property confiscated, and persons deported.

I have been advised that other companies are going to Canada to operate. I believe that the experience of the one company discouraged their flight.

6. Enforcement difficulties including that of jurisdiction encountered by the state:

A. Jurisdiction. Until January, 1982, there was a jurisdictional problem in that in 1975 the Commodities Exchange Act preempted state action. In 1979 the State of California repealed all commodity legislation. At present, the jurisdiction conferred by Title 7 USC § 16(e) appears to be adequate jurisdiction for the State of California to pursue violations of the securities laws which may occur within precious metals sales.

B. Other difficulties. Most of the investors who have complained live outside California. I notice in the Wall Street Journal, Western Edition, that the ads have telephone numbers in other states. It is my belief that California investors have been solicited by companies outside California, and that California companies are soliciting investors from outside California. The records of those companies which are under examination bear this theory out.

Another enforcement difficulty is the limited resources which the Department of Corporations must allocate to enforce 13 different state laws, only one of which is the California Securities Law. At present, we have 687 open enforcement cases. There are 20 lawyers, 20 investigators and 20 accountants available in the State of California to prosecute those 687 cases. Because of the State of California's primary statutory responsibility is to administer and enforce those 13 state laws, the State of California is reluctant to bring enforcement of actions under the Commodities Exchange Act.

Another difficulty encountered is that the administrative subpena duces tecum issued by our agency does not carry with it contempt power for failure to comply. If the respondent does not wish to comply, an order to show cause must be brought in the state court. The respondent must be served and given 10 days in which to reply. One continuance is granted him as a matter of right if he so requests. After the hearing, if the State prevails, the court gives the respondent another 20 days in which to produce. A simple subpena enforcement case can run over 30 days before production is effectuated.

7. The extent and cooperation of the CFTC, the SEC, and the FTC:

A. CFTC: Although willing to cooperate the CFTC has tremendous staffing problems. The entire western region is staffed with two experienced lawyers and two inexperienced lawyers at this time. The support staff consists of one secretary. There is no investigator and the Western Region must rely on investigation assistance from other regions.

B. SEC: The SEC forwarded one strategic metals case to us for enforcement in 1982. In a recent telephone conversation with the member of the staff, I was informed that the SEC was not aware of this problem until last week.

C. FTC: The FTC sought to aid us in February, 1984, however we had not begun our efforts and could not share information with them at that time.

8. Extent to which federal agencies should be involved in regulating and enforcing precious metals sales:

Full concurrent jurisdiction with the CFTC to pursue any violations of any federal laws which may come under their jurisdiction should be implemented. In addition, any sharing of information which the State of California and the federal agencies have engaged in in the past has put the State of California in direct conflict with its Freedom of Information Act. Each time the State of California seeks information from the federal agency, it must state that this information will not be disseminated until we received permission from the federal agency. This precludes us from sharing our information with other state agencies who may have resources available to pursue activities which we cannot pursue.

9. Recommendations, legislative or otherwise regarding elimination of precious metals fraud:

The current jurisdiction which the State of California now under Title 7 USC Section 16(e) has been a great aid in our enforcement efforts. Naturally, increased funding for federal agencies who are engaged in prosecution of this kind of fraud, either permanently or as a specialty is recommended.

PREPARED STATEMENT BY ORESTES J. MIHALY

BEFORE THE

Senate Permanent Sub-Committee on Investigations
on behalf of
Attorney General Robert Abrams
of the State of New York
by Orestes J. Mihaly,
Assistant Attorney General in Charge
Bureau of Investor Protection and Securities
Washington, D.C.
March 19, 1984.

It is indeed a privilege to appear before this Sub-Committee today on behalf of Attorney General Robert Abrams of New York to express his deep concern over the latest form of national scams that within the last two years have bilked the American public of aproximately 200 million dollars. I appear here today with two of my colleagues in the Bureau of Investor Protection and Securities -- Assistant Attorneys General Mark Tepper and Ronald Eisenman who are in charge of two of the major investigations in this area.

It was just about two years ago at the end of February of 1982 that we made an appearance before this Sub-Committee during the course of the reauthorization hearings concerning the Commodity Futures Trading Commission. It was at that same time that our office commenced what was probably the longest trial involving criminal boiler room activity in history, if not one of the longest trials ever in the State of New York. The trial involved the indictment which we obtained against the Mineral Resources Corp., its president, Calvin Bein, and twenty nine of its salespersonnel, charging them with scheme to defraud and securities fraud.

Let me briefly describe that prosecution. On July 13, 1981 after an undercover operation extending over a six to eight week period, arrests were made at two boiler room sites in lower Manhattan and at a hotel room which was the scene of the finale of our own sting operation. Indictments followed in August.

Pre-trial evidentiary hearings took place from February 13, 1982 to April 1, 1982. Then followed approximately six weeks of jury selection. The trial itself commenced with opening statements on May 11. Final closings by the People were given on August 27. The jury deliberated for 14 consecutive days while sequestered. The verdicts were returned the night of September 13, some six months after the commencement of the pre-trial evidentiary hearings.

This was the most significant and effective boiler room prosecution in the history of our office and most probably in the history of nationwide boiler room prosecutions in general. The successful conviction of 30 of the 31 individuals arrested who were involved in this fraudulent operation had a extremely chilling effect. It effectively diminished boiler room activity in New York and served to prove correct that which we had maintained all along; that is, that boiler rooms proliferate like the mythical "hydra". It is not enough to cut off the head, but it is essential to also sever the tentacles or the new growth of the beast. Boiler room salespersonnel, upon the closing of one boiler room, inevitably proceed to open up new and more numerous boiler room operations.We firmly believed that it was necessary, once and for all, to prosecute to the limit of the law, not only the owners or operators of the boiler rooms, but also the salespersonnel who were previously virtually untouched by prosecution.

We also believed that criminal prosecution was the only really effective deterent to this type of activity. It is obvious that it matters little to a boiler room operator to be the subject of some civil injunctive order or judgment, when he has secreted away hundreds of thousands or millions of dollars in some off-shore depository in the Cayman Islands or elsewhere.

The Mineral Resources case involved the fraudulent sale of 1.4 million dollars worth of a strategic metal known as Tantalum within a 2½ - 3 month period in 1981. We were able to infiltrate the operation even before the victims knew they were victimized and just as the operation was about to move into high gear with the establishment of franchised boiler rooms all over the country, using the methodology and materials of Cal Bein's operation. The prosecution cost the State of New York hundreds of thousands of dollars in man hours and out of pocket expenses. Witnesses were produced at the trial from all over the country in order that individual salespersons be confronted with their victims to enhance our chances of obtaining felony convictions by the jury against the individual salesperson.

Much of the credit for this forceful and calculated attack upon New York boiler rooms belongs to Attorney General Robert Abrams himself who personally authorized and encouraged this major prosecution and others which we launched in 1981 and 1982 primarily in the strategic metals field such as prosecutions against: Transcontinental Strategic Metals, Inc., Rockwell Industries, Inc., Republic Geological Inc., and Strategic Minerals Inc.

Of course, these boiler rooms were not registered as required with the State of New York, nor were they registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission. They maintained that they were not engaged in the securities or commodities business and thus were not subject to the jurisdiction of the regulators in these areas. They claimed to fall between the "regulatory cracks" since they were selling physicals for delivery, and not securities or futures contracts.

We, of course, proceeded on the theory that Mineral Resources was selling an investment contract form of security and were vindicated by the court's ruling and the jury's findings. In our approach to this problem we did not seek to find excuses for inaction and ignore the problem even though the public was harmed. We did not reason: "Well -- this may not be a security and thus we may not have jurisdiction -- or it may be a commodity concerning which we may be preempted by the Commodities Exchange Act and therefore we should not waste our time and efforts." Instead, we proceeded with an aggresive series of investigations and prosecutions.

Nor did we shun our responsibility by saying: "There are too few New York victims - it is therefore some other agency's primary responsibility to regulate and prosecute the illegal operations of Cal Bein." We have the responsibility not only to protect our New York citizens from being defrauded - but also to strive to prevent New York state from being a haven for crooks and thieves who prey on gullible people all over the country from respectable and impressive sounding New York addresses. The legitimate New York investment industry is a financial enterprise crucial to our local economy. It behooves all of us, - the legitimate business man, the Bar, and the regulators and prosecutors to clean out such predatory vermin from their nests in our particular back yards.

I think to a great degree that is what we have done! New York, since the Mineral Resources prosecution and those that followed closely behind in the 1981-1982 period, - has seen a significant reduction in boiler room activity, especially in the strategic and precious metals fields.

However, a new type of nationwide scam has appeared on the scene. We have again taken direct and aggressive steps to eliminate them. I, of course, have reference to the purveyors of alleged investments in precious metals who emphasize the safety of their storage facilities, the safety of investments in precious metals, lucrative rebate programs, payment of interest for metals stored, and the use of mass media advertisements and slick brochures instead of cold telephone call solicitations. In particular, we speak of two notorious operations - International Gold Bullion Exchange (IGBE) run by William and James Alderdice out of Ft. Lauderdale, Florida and Bullion Reserve of North America, operated by the now deceased Allan Saxon from Los Angeles, California.

IGBE advertised extensively in such prominent news papers as the New York Times and the Wall Street Journal, as well as T.V. commercials during prime time network shows such as the "Winds of War." The public thought, and in some respects may have had the right to believe that someone in authority "up there" in the government was watching over these people who so brazenly and outrageously solicited their monies in such an open and obvious way.

Experience in interviewing hundreds of boiler room victims teaches us that the public generally believes that government regulation of investments and mail fraud statutes leave little room for charlatans. How many times have we heard a victim say -- "... but I thought there was a law against fraud"; or say that one agency or another had to approve the sale of a particular investment. The boiler room operators know this. That is why when some of them are able to register with the C.F.T.C., they use such registration to enhance the credibility of their pitch to the vulnerable public. Your Sub-Committee heard such testimony in 1982.

The truth is that actually no regulator was monitoring these two operations. It is sad for me to say that had any regulator-state or federal-securities or commodities-timely requested or cursorily examined the records of these two operations, the loss of millions of dollars by the American investor would have been averted. Hundreds of poignant and tragic stories resulting from the loss of monies to these criminals never would have had to been told.

What actually was happening was the perpetration of a collosal and audacious Ponzi scheme. The very magnitude of the full page ads in the Times and the repetitious frequency of prime time media ads, contributed to the credibility and the air of legitimacy that this scheme engendered.

Over a thousand New Yorkers have lost at least $8 million dollars in the IGBE scam and about the same amount of investors has lost a still undetermined amount in BRNA. Nationwide losses from the operations of these two firms alone exceed one hundred million dollars. Another firm, J. David & Co., also in Los Angeles, within the last two or three weeks has gone into bankruptcy. Newspaper reports and conversations with the trustee indicate that this currency dealer may be in a similar posture as IGBE and BRNA with staggering losses that some have estimated to be in excess of 125 million dollars.

In the cases of IGBE and BRNA we were faced with scams of gigantic proportions - much more than the amounts involved in the strategic metal boiler rooms. This time, moreover, the perpetrators were thousands of miles away from us, operating primarily from Florida and California.

The Attorney General was convinced, however, that again criminal action, if warranted, against this type of operation was the appropriate response. And so we proceeded to obtain indictments against the principals of IGBE in Westchester County, New York charging them with Grand Larceny and intentionally using fraud in the sale of securities, in July of 1983. Their bankruptcy filing in early May revealed the extent of the public's loss. Arrests were effected in Florida on July 14, 1983. They are presently in federal custody as a result of a subsequent indictment obtained by the U.S. Attorney's Office in Miami, Florida. They are held on high bail and are continuing to vigorously fight extradition to New York.

A few months after the collapse of IGBE, in the late summer of 1983 BRNA started a pervasive radio blitz over New York's all news radio station WCBS extolling the safety of their storage facility which was reputed also to be the depository of the Mormon Church in the Wasatch Mountains in the State of Utah. Attorney General Abrams heard these slick radio spots himself while listening on the car radio on the way to his office. He directed the Bureau of Investor Protection and Securities to intensify our efforts and to determine whether this radio pitch was another example of something loudly proclaimed, but completely false.

The rest is history. We contacted the principals of BRNA and their attorneys and ultimately arranged for Alan Saxon to appear at our office in late September in order for him to detail to us the nature and financial condition of his business. He never appeared on the scheduled date September 28, 1983 but was represented at our office by his vice president for legal affairs, Richard Arfa, and local New York counsel. These representatives reassured us that (1) everything was well with the company and its operations (2) that 95% of the business of the company involved direct delivery of bullion to the customer; and (3) that the company was not involved in trading in the futures market. At the very moment these representations were being made to us and while we were demanding the immediate production of financial figures and records - the body of Alan Saxon, who we later identified as Alan Margolis, was being processed by the police in Los Angeles as a result of the discovery of his suicide a few hours earlier. The next day we were in communication with the firm's counsel in Los Angeles who revealed his discovery of a sixty to eighty million dollar loss for investors.

Again the public had been the subject of an outrageous Ponzi scheme. Saxon frittered away tens of millions of dollars on high living, expensive sport cars, jewelery for his wife and girl friends and speculation in commodities with major U.S. commodities brokers. The public's reliance on representations that they were entrusting their monies in a safe investment was a complete and tragic farce. We are still continuing our investigation to determine the culpability of others connected with Saxon's company and to determine if we can aid in the restitution of monies to our New York citizens.

Again no regulator was really on top of the situation to prevent or anticipate its ultimate collapse. It all seemed "to good to be true!" - "too legitimate!" "too credible!" - Who would have the audacity to perpetrate a fraud over WCBS radio? It was only after we decided to act that the bubble finally burst. Our investigation has uncovered a tragic scenario that requires remedial action. It reminds us somewhat of the infamous case of Kitty Genovese in New York City many years ago in which a young woman was attacked near her home by her murderer. Her screams for help, extending over a long period of time, went unheeded by dozens of her neighbors who just didn't want to get involved. We have found during our investigation that two, very legitimate accounting firms which were engaged to conduct financial audits of BRNA, became aware of huge deficits and shortages in BRNA in 1982 and 1983, more than one year before the public disclosure of the fraud. No regulator or prosecutor was informed of their findings and no one in the firm who might have been aware of the findings came forward to expose Saxon. The scams continued virtually unabated and the volume of incoming receipts actually increased.

In late October of 1983 Attorney General Robert Abrams brought these matters to your attention. He asked that your Sub-Committee commence an inquiry to determine whether or not there should be a legislative response by Congress and to determine whether there had been an appropriate federal regulatory response. The SEC has been quoted in the media as maintaining that it did not have jurisdiction because securities were not being offered or sold. The CFTC claims it had no jurisdiction because these operations were cash transactions in physicals. The FTC is reported to have explained that the case was "too big" for them.

Let me briefly point out two other precious metals dealers with which we have been concerned in the last six months. United Precious Metals of Boca Raton, Florida is almost a carbon copy of IGBE with virtually the same modus operandi.

Fortunately, it was not able to continue its Ponzi operation as long as IGBE and its total impact on the public was significantly less. We estimate that its operation has led to the loss of twelve million dollars by the public. We are currently actively involved in a criminal investigation in that case.

In addition, in November of 1983 we proceeded by an investigative order against Empire State Metals Inc. located in a suburb of New York City on Long Island. This operation quickly closed its doors, and with most of its sales people returned to Florida where it has started up again under another name. The principal of Empire is William Wolfe who now functions as a "consultant" to a firm called Nationwide Metals Inc. of Ft. Lauderdale, Florida. The whole operation seems to be connected to several others in Florida, as well as being the successor to Universal Precious Metals, an operation allegedly put out of busines by the CFTC in 1982 after a raid on their premises by the F.B.I. This melange of companies and associated personnel engage in the alleged sale of leveraged contracts and sales of physicals in precious metals. We are in the midst of an intense investigation to determine whether their operation was or is actually a bucket shop operation.

It is obvious that the "regulatory cracks" have been wide and that these unscrupulous con men and their lawyers have taken advantage of this fact. These nationwide frauds are basically and primarily a national problem. All of the federal regulators should have been more aggressive in their attitude, especially the CFTC, which upon the slightest inquiry would have discovered so-called leveraged purchasing by customers of Bullion Reserve of North America over which they had exclusive jurisdiction. We believe that the CFTC could have proceeded against BRNA or IGBE under the holding in CFTC v. Co Petro Marketing Group Inc., 680 F.2d 573 (9th Cir. 1982) in which the court rejected the defendants' argument that they were simply selling cash forward contracts, which fall outside the agency's jurisdiction, since Co. Petro customers "were, for the most part, speculators from the general public (who) had neither the intention of taking delivery nor the capacity to do so." In reaching this conclusion, the Court held that in enacting the Commodity Exchange Act, Congress did not intend the "cash forward" exclusion to extend to agreements for the future delivery of commodities sold merely for the purposes of speculation, but rather "has expressed its desire to protect speculators through expansive federal regulation." (680 F.2d at 579).

Whether or not the CFTC or any other federal agency would have been successful in their attempts to uncover the true facts or in asserting jurisdiction is not as critical as the fact that none of them even tried.

It is disconcerting to realize that regulators who are subject to budgetary restrictions and staff shortages - establish priorities that may shift emphasis to investigations over which they have obvious jurisdiction - leaving the scams and frauds that are not quite of the "garden variety" type or so called exotic frauds to some other agency. Unfortunately, the other agency may also have the same problems and priorities. This "leave it to someone else" attitude results in the American public being left exposed and vulnerable to the fraudulent operator.

We are obviously extremely gratified that this Sub-Committee has taken the time and effort to look very carefully into this serious problem to order to fashion a response either in a legislative mode, or by focusing the attention of federal regulators on this area and perhaps suggesting readjustments in their priorities and creating by this hearing a climate of greater awareness for the American public of the dangers of such investments.

What should the response be? We urge continued and increased vigilance by the regulators and prosecutors, - by the Congress and the state legislatures, by our executive branches of government and by the public.

We, in New York, have proposed certain amendments to our Martin Act (Article 23-A of the Gen. Bus. Law) the statute which provides us with our regulatory jurisdiction and responsibility. We have forwarded drafts of this legislation to your staff for your consideration. Basically these proposed bills would (1) make boiler-room type solicitations by unregistered persons illegal; (2) would require state registration of those selling commodities who are not registered with the CFTC, and (3) would require delivery or segregation under stringent financial requirements by vendors of precious metals. We are asking the New York legislature to pass these laws, not only for the benefit of New York residents or those who reside elsewhere who deal with New York based boiler rooms, but also that they may serve as models for other states to consider and perhaps for the Congress through your Sub-Committee's sponsorship. Certainly, Congress should make clear that the type of precious metal sales which we have described are subject to the present law and enact legislation to close the regulatory cracks.

All regulators-federal, state and local - should be more aggressive in asserting their jurisdication - not preempting each other, but by vigorously engaging in enforcement action against the malefactors. There should be an end to turf fighting and a spirit of genuine cooperation. I think that we are reaching that point with the C.F.T.C. Regulators should not be averse to changing their priorities to include the exotic and the extraordinary investment vehicle. Executive branches and their budget directors should give the regulators and the prosecutors sufficient staff and resources to solve these problems. Many innovative techniques and new technology in inter agency coordination and cooperation can be initiated, if appropriate financing is available.

The CFTC alone can not handle these massive, nationwide commodity frauds and regulate the legitimate commodity industry with only one hundred persons in its enforcement section, including lawyers, investigators, clerks and stenographic help. This is ludicrous! The con artists know this and use this obvious weakness to their advantage. The CFTC should be more adequately funded to provide for a significant increase in enforcement capability. De-regulation at the cost of the millions of dollars lost by the investing public and the trauma of such loss is obviously against the public interest.

The public should be made become more aware of the dangers of investing over long distance wires and through the mails - dealing with firms and people they have never seen. All of us should strive even harder to educate the public so that they may become more aware of frauds and how they are perpetrated.

During the course of public hearings concerning Boiler Room abuses conducted by Attorney General Abrams New York in 1983, we listened to graphic examples of the tremendous emotional and physical trauma caused to our citizens by the loss of their investments. Victims suffered strokes, heart attacks, depression and feelings of despair. Thoughts of suicide and suicidal gestures destroyed the final years for many senior citizens. White collar crime is not a pleasant thing. In many cases it can have an impact on the lives of victims greater than violent crime. Yet it can be the most preventable of crimes. Not enough effort is exerted in preventing white collar crime. State and national legislatures are reluctant to legislate because of the fear that legitimate businesses may be hampered. Inadequate resources are provided to white collar prosecutors because of the myth that white collar crime is something to be less concerned with than violent crime. Overcrowded jails lead to the early release of white collar criminals, because they are "less dangerous" making a mockery of their prosecution.

Finally, white collar crime of the kind that we are concerned with here can be significantly reduced by initiating a dramatic effort to raise the level of the public's awareness. Education of the public or public awareness will not eliminate the bank embezzler or the credit card thief - but the boiler rooms can be significantly deterred by intensive publicity and public awareness. We urge that this subcommittee include in its recommendations some significant federal response, not only with respect to the prosecution of these undesirable elements, but also the prophylactic effect of a serious, well financed, well conceived educational program for the American public, encompassing perhaps the public educational system.

It is only by the concerted efforts of all of us that this and similar problems can be brought under a greater measure of control. In conclusion, let me once again express our high regard for this Sub-Committee's continuing concern for the American investing public and applaud your efforts in this area. It has been a pleasure for us to work with you and your fine staff; especially, Chief Counsel, Cass Weiland, former Deputy Counsel, Rodney Smith, Carol Fox and Phil Ward. We trust that the American public will benefit from all of our efforts.

PREPARED STATEMENT OF EARL FAIRCLOTH, TRUSTEE
OF THE
INTERNATIONAL GOLD BULLION EXCHANGE

The International Gold Bullion Exchange, Inc., is a Florida corporation formed in 1980. There is a Texas corporation with the same name with headquarters in Dallas, and a California corporation with headquarters in Los Angeles. These corporations operated from their management base in Fort Lauderdale. They were engaged in the buying and selling of gold. They employed a far-flung advertising campaign with full page ads in newspapers in the larger cities of the country. The public was invited to buy gold from International Gold Bullion Exchange, as the said largest gold operation in the world, with many assurances of safety and soundness of investments. Inducements were made to the buyer to accept the offering to pay a commission of one and one-half to three and one-half percent monthly until the gold was actually received by the customer, or they would accept the metal for safe-keeping and pay one and one-half percent per month to the customer for the privilege of keeping it in their vault. An elderly gentleman from Colorado called to ask when he could come and pick up his coin collection worth $25,000 which was in the vault. We explained to him that there was nothing found in the vault except some painted wooden gold bars. He had some choice comments about the system whereby he could lose this much money.

The company operated a high pressure boiler room type sales program all over the country, enticing people to send their money and buy their gold and other precious metals from International Gold Bullion Exchange.

The program developed rapidly during 1981 and 1982. Preliminary conclusions are that in 1982 there was about Eighty Two Million Dollars ($82,000,000.00) in gross sales.

This continued during the first 2 to 3 months of 1983 when the Florida Attorney General's Office sought the appointment of a Receiver and closed the operation down. This action was taken because of the growing number of complaints that orders were not filled after the customer sent in his money. Shortly thereafter, the debtor corporation filed a Chapter 11 proceeding in the Bankruptcy Court for the Southern District of Florida. Within a few weeks, the Court appointed the Trustee to take over the management of the bankrupt estate.

The corporate offices were located in four floors of a prestigious office building in Fort Lauderdale. The offices included an enormous vault. Nothing was found in the vault except some old typewriters and approximately 30 gold bars. The gold bars happened to be painted wood blocks shaped like a gold bullion bar. At the auction, these bars sold for $20.00 each.

At the time of my appointment in late May 1983, there were an estimated 25,000 creditors. This figure was subsequently reduced to in excess of 23,000.

The preliminary duty of the Trustee in the management of the estate is to seek out and take possession of all property belonging to the estate. To date, we have recovered and taken possession of approximately Four Hundred Thousand Dollars ($400,000.00) in assets. 13,184 of the estimated 23,000 creditors have filed claims. The total dollar amount of these claims to date is Seventy-Five Million, Eight Hundred Thirty-Five Thousand, Six Hundred Three Dollars ($75,835,603.00). The Court has not yet set a deadline for filing claims and they continue to come into my office.

We have encountered many problems in marshalling the assets of this estate. This activity has been performed by seeking information from cooperative police in Florida, particularly the City of Fort Lauderdale Police Department and the Broward County State Attorney's Office. We have followed up leads about possible location of assets. The FBI has been helpful, the several State Attorney Generals, particularly of Illinois, Texas and Florida, have been of great help. The trail led us to some 37 subsidiary corporations. We negotiated a turnover from the principals of International Gold Bullion Exchange, namely William and James Alderdice, of the stock of 25 of these corporations. This has resulted in a recovery to date of approximately Twelve Thousand Dollars ($12,000.00). We have sent turnover demand letters to banks all over the country and by this method have recovered a considerable part of the $400,000.00 marshalled to date. We have several suits pending, one of them involving the ownership of Certificates of Deposit in California. We have a potential suit against some banks who were used as a conduit for nearly Five Million Dollars ($5,000,000.00) in wire transfers during the last two months of the operation of the business.

Several other law suits are being readied which hopefully will produce other assets.

The main asset uncovered was an interest in a gold mine venture in Alaska. The two principals, William and James Alderdice, had used corporate funds to purchase this interest in a limited partnership engaged in a gold mine venture and, out of the operation, they would have received approximately 30% of the production of the gold mine. The venture was scheduled to begin operation in July 1983, but due to permit problems, lack of adequate financing and the weather, the operation did not succeed. We have been engaged in intensive negotiations to keep the venture alive because profits from the gold mine operation represent the only possibility of paying the creditors anything at all. But for this possibility, in view of the limited assets we have been able to marshal, the creditors will probably suffer a total loss.

We have pursued every lead available to us and have not been able to determine whether the company used off-shore bank accounts. We are still attempting to pursue leads of that nature. It is impossible to estimate with any degree of accuracy the average investment. One method would be to average out the 13,134 creditors who have filed claims totalling in excess of Seventy-Five Million Dollars ($75,000,000.00). As stated above, unless the gold mine mine venture succeeds, the claimants will probably not receive anything inasmuch as the amount recovered to date will not even pay administrative expenses.

The administration of the estate has been hampered by the lack of an audit. Consulting with national accounting firms, it is estimated that the cost of such an audit would exceed One Half Million Dollars - more than the total we have recovered thus far. It is also estimated by the accounting firms who have made a preliminary examination of the records we have uncovered that probably an accurate audit could not be made because of the absence of so many records. The accounting procedures of the corporation were, at best, disorganized. For example, on the basis of what we have discovered in Fort Lauderdale headquarters, there were two separate bookkeeping operations on different floors and neither department was allowed to communicate with the other. It may have been a double or triple entry bookkeeping system like no other in recorded history. Or, it may have been just inefficiency and lack of organization.

Some very rough estimates of overhead and expenditures have been made. For example, the Fort Lauderdale office comprised four floors of a prestigious office building in downtown Fort Lauderdale. Their annual rent was One Million One Hundred Sixteen Thousand Dollars ($1,116,000.00) per year. Dallas annual rental was One Hundred Twenty Thousand Dollars ($120,000.00) and Los Angeles was Three Hundred Ninety-Six Thousand Dollars ($396,000.00) - totalling One Million Six Hundred Thirty Two Thousand Dollars (1,632,000.00) in round figures for rent. Pursuing rough figures for overhead has been difficult because records are simply not available. We did find that during the first three and one-half months of operation during 1983, the Fort Lauderdale office carried 497 employees at a total gross expenditure of Three Million Eighty Four Thousand Dollars ($3,084,000.00). The Dallas office carried approximately 67 employees and the Los Angeles office 93 employees. Assuming an overhead figure of Twenty-Five Million Dollars ($25,000,000.00) per year for rent, salaries, furniture and equipment rentals, and telephone for all three offices, it still does not account for the $75,000,000 plus which claimants thus far have registered.

Conclusions can and have been drawn that all of the extravagant operation and inefficient business practices would not account for the cash sent to them by 23,000 creditors. Where did the money go? We cannot have any chance to find out unless there is money available to conduct a proper audit, assuming the complete records were available. It appears that this operation was begun by corporations formed in the usual way in three States, doors opened for business in the county with, presumably, nothing more than a county occupational license. There was no State or Federal regulatory agency that controlled them in any way in their operation.

The need for supervision and minimum standards is obvious from the results of this case.

PREPARED STATEMENT OF RICHARD F. MIKLIC

My name is Richard F. Miklic. I am a Supervising U. S. Probation Officer in the Southern District of Florida at Miami. With me today are Mr. Martin Carroll, U. S. Probation Officer, and Carlos Juenke, Chief U. S. Probation Officer for our district. We have, collectively, some thirty-five years of experience in probation and parole work.

Before his appointment as Chief in our district, Mr. Juenke was supervisor of the Special Offender Unit in Dallas, Texas, and a member of the faculty of the Federal Judicial Center teaching the investigation and supervision of the white collar offender. Mr. Juenke formed a similar Special Offender Unit in our district almost one year ago. Mr. Carroll is a member of the unit and I am the supervisor in charge of it.

The purpose of the Special Offender Unit is to provide special handling of the sophisticated, professional criminals who abound in South Florida. These include major drug traffickers, organized crime figures, and the fraud artists currently under investigation by this subcommitee.

The securities and commodities swindlers are by far the hardest and most frustrating cases for us to handle. One of the things which we have noticed is that these offenders rarely restrict themselves to one kind of investment fraud but will engage in whatever kind is easiest and most profitable at the time. I would like to take this opportunity to share some of our post-conviction experiences with these offenders and make some suggestions about how the resources of the Federal Probation System could be better utilized to help control investment fraud.

Prosecuting and convicting these offenders is a necessary first step in imposing control. However, it is just as important to do something meaningful with them once they have been caught.

We believe that if these swindlers are given minimal confinement sentences or are placed on probation without any real supervision, then all of the time and effort invested in convicting them will really have been in vain.

We have observed that these offenders are particularly brazen and persistent in continuing their illegal activities after conviction. A few examples from our current cases will help demonstrate how difficult it is to deter them.

One of Mr. Carroll's cases was convicted of investment fraud in 1981. Sentencing was continued for about thirty days so that a presentence report could be prepared by our office. The defendant made a written statement to the court that was included in the presentence report in which he expressed great remorse and assured the court that his new employment was strictly legitimate. However, he was at that very same time using this new company to defraud additional investors of more than $31,000. Our office did not become aware of the new offense until the defendant had completed a term of confinement and had been released on probation. We are now seeking to have that probation revoked.

We have another case who was convicted of investment fraud in 1978. He was also sentenced to confinement with a period of probation to follow. However, he took an appeal and was allowed to remain free on bond while the appeal was being decided. We eventually learned that this man committed another substantial fraud while he was free on appeal bond. We are also seeking to have his probation revoked.

Probably the most brazen example involves one of my own cases who was recently before the court for revocation of probation. This man also received a period of confinement with parole and probation to follow. The court rejected his request that he be allowed to serve his four month confinement term in a halfway house. Nevertheless, he convinced prison officials to transfer him to such a facility after spending only two weeks in custody.

There is strong evidence that this man spent no more than two nights at the halfway house. He apparently conspired with the woman who was in charge of federal prisoners to cover up his absence by forging documents which were sent to the Bureau of Prisons.

What we did establish conclusively at the revocation hearing was that this offender left the halfway house on two occasions and travelled from Fort Lauderdale to Los Angeles. Legally, this constitutes escape; and the reason this escaped prisoner travelled to Los Angeles on at least one occasion was to induce someone to invest in a multi-million dollar tax sheltered gold fraud. We became aware of the unauthorized travel because the investor later complained to the SEC and the Florida Comptroller's Office about his losses.

Finally, we have a case of Mr. Carroll's who is currently on probation for commodity fraud. He also has several other indictments pending for the same kind of "boiler room" fraud. At Mr. Carroll's suggestion, the court imposed a special condition that the defendant's self employment must be approved by the probation officer.

The offender told Mr. Carroll that he was operating a maid service. However, when Mr. Carroll and I made an unnanounced visit to his place of employment, we found a typical boiler room operation in full swing with staff selling gold ore over the telephone. The offender had a large office in the rear and was obviously in charge, which was confirmed by documents that we saw there. He continued to insist, however, that he was simply sharing office space and had nothing to do with the gold ore operation. When we requested further documentation he told us that all of his records had been stolen.

These are only a few examples but I believe they show how the professional swindler continues his criminal activities after conviction: while under presentence investigation, on appeal, in confinement, and under supervision. It has been our experience that these offenders generally have nothing but contempt for the criminal justice system. We believe that the only effective deterrent for them is the threat of substantial confinement sentences like those handed out to drug traffickers and organized crime figures.

These offenders are equally contemptuous of their victims. The professional swindler generally "owns" only the clothes on his back: he rarely has any visible assets which can be used to compensate his victims. These offenders will often refuse to provide any financial information during the presentence report, usually on "advice of counsel". Other techniques include placing assets in the spouse's name, into a trust account, or into secret offshore bank accounts. Again, I think that a few examples will help show what the victims are up against.

First, let's look at Mr. Carroll's probationer who was supposed to be operating the maid service. Pursuant to the special condition of probation, Mr. Carroll instructed the probationer to move out of the offices where the gold ore boiler room was operating and to have nothing further to do with it. The offender claims to have complied, although this is doubtful. However, he has now stopped making restitution payments, which was another condition of his probation: he claims that Mr. Carroll has forced him to become unemployed and says that he can no longer afford to pay. He claims no assets although at the time of sentencing, he was living in a plush apartment overlooking the Atlantic Ocean with a monthly rent of $750.

I also have a man on probation for a multi-million dollar tax shelter fraud involving coal. He was not ordered to make restitution as a condition of probation but he is being sued by some of his victims. He lives in a home which is worth almost one million dollars; he has the use of several expensive automobiles, including a DeLorean sports car, which he usually drives; he wears an expensive Rolex watch; and his children are enrolled in expensive private schools, among other things. However, his victims will never be able to collect from him even if they should win their suit because this man, like most professional swindlers, is "judgement proof".

You see, he did not want his wife and children to suffer for his mistakes. So after he was convicted, he agreed to a divorce and property settlement which gave all assets to the wife.

When this offender arrived at prison to serve his confinement sentence, he conveniently forgot to tell officials about the divorce. Within a month of his arrival, he was given an emergency furlough to return home and spend time with his wife, a privelege to which he would not have been entitled if it had been known that he was divorced. A psychiatrist had written a letter to the Bureau of Prisons stating that the inmate's wife could not cope on her own and would suffer a complete breakdown unless her husband could come home to comfort her.

After this offender was released to the probation portion of his sentence, he immediately reunited with his wife and they were remarried a short time later. However, he still did not want his family to suffer on his account so he signed a pre-nuptial agreement renouncing any interest in the family assets.

This explanation of events was given to me personally by the probationer. I should also note that I have received information from a reliable source that he has substantial sums of money in secret offshore bank accounts.

Again, these are just a few examples but I believe that they demonstrate what the victims are up against.

We believe that the post-conviction stage, which includes sentencing and community supervision, is an important part of the criminal justice process. We also believe that the Federal Probation System, which handles the post-conviction stage, can play an important role in helping to compensate victims of commodity investment fraud and protecting society from additional violations. If presentence reports on these offenders are properly prepared, they will help convince the courts of the danger to society and of the need for strong deterrence and control. Proper supervision will make it difficult for these offenders to commit new crimes and will help return them to prison if they do.

In our view, the most effective sentence for these offenders is what is called a "mixed sentence", where there is more than one count involved. A substantial confinement sentence can be imposed on one count, to act as a deterrent to the offender and to others like him. The maximum five years of probation can be imposed on the other count, to begin upon release from confinement. Such a sentence not only deters but keeps the offender under close control for a long time. We have asked the U. S. Attorney's Office in our district to seek guilty pleas to multiple counts, whenever possible, so that we can recommend this kind of sentence in fraud cases.

We also recommend a tightly structured probation. The best tool in these fraud cases is a special condition prohibiting the offender from engaging in any employment involving the offering of commodities or securities during the period of probation. A special condition requiring restitution is also essential. We also recommend a condition that the offender make full disclosure of his personal and business financial records. The probation officer can enlist the help of staff of the IRS, the SEC or other agencies to help him conduct such audits.

It is our assessment that the Federal Probation System is ill-equipped for this task at the present time. Most officers come to the job with backgrounds in social work, counseling or the liberal arts. They have little expertise in financial investigation and tend to handle sophisticated fraud cases in the same manner as "street crimes" like mail theft or bank robbery. As a result, presentence reports on these offenders are usually social histories which tend to show them in a favorable light. They are often given minimal supervision because they appear stable and lack the problems with family, unemployment, or substance abuse which often characterize the "street" criminal.

Some progress is being made. The Administrative Office of the U. S. Courts has recently published a monograph which discusses methods of dealing with white collar offenders. Specialty positions have also been authorized for officers dealing with special offenders. However, much remains to be done. Officers working with these offenders have had to acquire most of their training on the job or through other agencies like the IRS. There is no central coordinator in Washington as there is for officers who specialize in working with drug abusers. We lack modern equipment like computers which would provide for coordination between districts.

It is our recommendation that the Administrative Office of the U. S. Courts be encouraged to establish a nationwide network of specially trained officers who will handle sophisticated fraud and other professional crimes in the manner suggested above. Formal training and modern equipment should be provided to these officers. A formal set of guidelines and procedures should also be developed to ensure uniform handling of these cases throughout the country. An administrator should be provided in Washington to oversee the program and assure coordination between the districts. A centralized data bank should be maintained to help monitor the activities of these sophisticated offenders.

In summary, Mr. Chairman, we greatly appreciate the opportunity to appear today. It is clear from my statement that problems we face do not lend themselves to legislative solutions, but I think it is important to inform the public of our difficulties. These hearings help to dramatize the vicious nature of these schemes and, hopefully, to warn future investors of their dangers.

STAFF STATEMENT
HEARINGS ON PRECIOUS METALS FRAUD

Mr. Chairman and Members of the Subcommittee:

In February 1982, the staff of the Permanent Subcommittee on Investigations (PSI) held public hearings on commodity investment fraud, following an eight month investigation by the PSI staff. The hearings centered on off-exchange transactions which, by their nature, are more susceptible to fraud and on the federal agency responsible for regulating the futures industry, the Commodity Futures Trading Commission (CFTC). Hearings on Commodity Investment Fraud Before the Permanent Subcommittee on Investigations of the Senate Governmental Affairs Committee, 97th Cong., 2nd Sess. (1982).

The Subcommittee determined that an average of more than $200 million a year was being lost to commodity investment fraud schemes, accounting for estimated losses of over one billion customer dollars between 1975 and 1982. The Subcommittee discovered that the majority of commodity fraud schemes are contrived by an identifable cadre of recidivists who systematically generate fraudulent operations throughout the country. The operators of these scams are drawn to the business by large profits and slight chance of criminal prosecution. Principals and salesmen move freely from one operation to the next, avoiding prosecution and "earning" huge undeclared incomes. Firms which operate for only short periods of time may still succeed in bilking investors out of hundreds of thousands of dollars.

A review of the CFTC files and procedures revealed that the agency was outmanned in its attempt to stem the tide of commodity fraud. Meanwhile, states anxious to protect their citizens were forbidden to enact commodity fraud legislation or to enforce the existing securities laws to allow them to effectively join in the fight against commodity fraud.

Following the hearings, the Subcommittee issued a Report which recommended, among other things: (i) the elimination of restrictions against state efforts to prosecute commodity fraud; (ii) free exchange of information between states and the CFTC; and (iii) concurrent jurisdiction between the CFTC and states on any commodity contract not traded on an exchange, including leverage contracts. S. Rep. No. 97-495 (1982). Later that year, Congress enacted the Futures Trading Act of 1982 which encouraged state enforcement actions by expressly authorizing state officials to bring actions in state court to enforce the Commodity Exchange Act (CEA). It also provided for "open season" on off-exchange commodity fraud which specifically authorized all federal, state and local officials to prosecute non-registered individuals under any relevant law or regulation.

The collapse of several large precious metals trading companies triggered a new investigation by the Subcommittee in October 1983, as a natural outgrowth of the Subcommittee's 1982 investigation and hearings. The primary purpose of the study was to determine what factors, if any, exist within the federal regulatory scheme which might be contributing to the continuing victimization of investors across the country and to determine the role that federal and state regulatory and enforcement agencies should play to prevent this problem.

Since October 26, 1983, Subcommittee staff has interviewed numerous individuals, including investors, precious metals dealers, consumer protection agencies, federal, state and local enforcers and regulators, and industry representatives. We have also visited a number of firms which deal in retail sales of precious metals in South Florida, Southern California, New York, and the District of Columbia.

Several key issues surfaced during the course of the staff study, including: the necessity for criminal prosecution of individuals engaged in precious metals fraud; the failure of a "consumer safety net" resulting in part by the refusal of federal regulatory agencies to assume jurisdiction; the lack of adequate state legislation; and federal and state enforcement problems of manpower and conflicting priorities; and the inability of any one agency or group to control the problem.

I. Precious Metals Fraud

A. General

In the last few years, precious metals fraud has developed as one more investment fraud that has cost the public millions of dollars. The perpetrators of precious metals scams profess to offer valuable investments in gold, silver or other metals in the form of bullion or coins to the public, but typically such individuals are "precious metal dealers" in name only. Unlike reputable bullion dealers, they do not possess the precious metals which are the subject of the sale or have the ability or intention to obtain such metals to fulfill their obligations.

Typically, these companies operate from "boiler rooms" - usually rented rooms crammed with desks, and phones and salesmen hired for their brazen persistence alone. Salesmen either make unsolicited calls to unsuspecting individuals or respond to information requests from individuals responding to extremely slick mail solicitations or advertising campaigns on prime time television, radio and in major newspapers.

B. Types of Contracts

While programs utilized by different precious metals swindlers vary, the most common types of contracts are either delayed delivery or leverage-type contracts. In the former, customers generally pay for their orders in full via use of credit cards and bank wires, or by mailing in cash, checks or money orders. More often, customers buy metal on leverage or installment-type contracts for future delivery.

C. Victims

Our interviews with the people who invested in precious metals lead us to the conclusion that no particular group of individuals is singled out as victims by the scam artists. Although many victims are retirees, fearful of inflation and trying to hedge their savings, many other victims are scattered among different social and economic groups. A surprising number of well-educated professionals were bilked out of thousands of dollars and among them were doctors, engineers, lawyers and clergy. A 56-year old priest was defrauded of a $45,000 investment, (which was money he received from his father's estate) in an attempt to aid his parish community. A 72-year old widow parishoner was also a victim after she invested nearly her entire life savings of $36,000.

Many victims have little or no experience in precious metals investments. They have either relied on their minimal investment experience in stocks and money market fund accounts or they are new to the investment game and gamble that what is being presented to them in the slickly worded advertisement is being done so honestly. Numerous investors told about one precious metal firm that ran large advertisements in the Wall Street Journal and Los Angeles Times and that some form of ad appeared daily for months. The victims of this firm were also regular readers of newspapers and thought publishers screened out advertisers who would defraud the public, but found out too late this can not always be done.

Other victims were lulled into their precious metal investments through impressive advertisements received through the mails. A California-based precious metal dealer used the mails almost exclusively to generate customers and then offered a toll-free telephone number to take their orders. A 39-year old federal worker invested $9,000 of his own money and his 64-year old mother invested $7,000 in this manner. They both lost their entire investments relying solely on the printed material received by mail from the firm. As this victim said later, "It seemed like a very well organized and convenient method for the small investor like me."

While some investors we interviewed were defrauded primarily by mail, most of them were made victims in the classic "boiler room" manner: the telephone call from the salesman without a face. Some victims received calls after first mailing a coupon from an advertisement, while others received what are referred to in the industry as "cold calls", unsolicited and unsuspecting to the victim. Most victims said they did not buy any precious metal on the first call, but after several calls they eventually entered into some type of contract with the salesman. Just as there are a variety of salesman and programs being offered, there are also a vast number of misrepresentations or lies made to the potential victims to close a deal. Victims are led to believe that risks are minimal and eventually the salesman will make money for them. Although victims could demand immediate delivery of gold or silver upon payment, very few are encouraged to do so since deferred or extended delivery is the objective of these companies. Salesmen will apparently tell victims almost anything they want to hear in order to gain their confidence and friendship over the telephone. Some victims are pressured into gold purchase through scare tactics, as salesmen cry of impending economic doom if the victim fails to buy now. During a recent investigation in the Northeast, a salesman's telephone solicitation was electronically taped and he was heard to say to a potential victim: "This economy is passing over your head and it's going to rain on you if you don't get some shelter (gold)... what are you going to do about it? I want some action from you!"

D. Location

South Florida and Southern California are the capitals of such fraud. The reasons are numerous, including: an abundance of willing and experienced "boiler room" salesmen, fair weather, low rents, wealthy investors and the fast life. Easy access to offshore banking and drugs, and what some perceive as a lax attitude toward criminal prosecution of white collar crime because of the priority of violent crime also make South Florida an attractive haven for precious metals schemers. In the last five years, the Florida State Comptrollers Office has received over 600 complaints concerning over 35 precious metals companies located in the state. Florida authorities report that incidents of precious metals fraud have increased in the past two years. The Comptrollers Office currently is investigating approximately 50 off-exchange commodity fraud and precious metals firms. Meanwhile, the California Department of Corporations currently has issued subpoenas to approximately twenty precious and strategic metals dealers in the state and estimates that a number of other questionable firms may exist.

One of the biggest problems for customers and law enforcement agents alike is differentiating between honest dealers and frauds. Authorities say that most dealers who sell gold and silver over the counter for two percent to four percent commissions are legitimate, but customers should be aware of companies that also promise profits of 50 - 300 percent in the unpredictible commodities markets, especially if companies make their pitch over the telephone.

E. Specific Companies

At least five major precious metals companies have collapsed in the past two years, with approximately 40,000 customers losing more than $125 million in the aggregate. While all of these companies were investigated by state and federal officials at some point, none of the principals of these companies have been convicted and principals of only one of the companies have been criminally indicted.

The following is a brief sketch of five companies which collapsed:

(1) Bullion Reserve of North America

From 1981 until 1983, through a massive nationwide advertising campaign, Bullion Reserve of North America (BRNA) promised high returns on investments in gold, silver and platinum, both bullion and coins, and offered to store the metals purchased by investors in secure vaults, one of which was located in a mountain in the state of Utah.

In September 1983, the chairman and principal owner of the firm, Alan Saxon, committed suicide, leaving a message indicating that the firm was unable to meet its obligations. Mr. Saxon's death followed a rush of customers to liquidate their holdings of bullion and coins that were supposed to be stored for them in the Utah vault. The rush was sparked by warnings in two precious metals newsletters that there appeared to be irregularities in procedures at Bullion Reserve. A subsequent inventory of Bullion Reserve assets indicated that more than $60 million worth of bullion could not be accounted for.

Investigators indicate that tens of millions of dollars may have been diverted by Saxon from BRNA for numerous purposes other than those for which investors gave their monies, including highly speculative commodity futures trading and personal loans used to purchase beachfront condominiums, luxury cars, and other property.

Immediately following Saxon's suicide, BRNA filed a petition for voluntary bankruptcy. It appears that approximately 20,000 investors lost as much as $60 million. There are no pending federal or state indictments against BRNA employees for their participation in BRNA.

(2) International Gold Bullion Exchange

On April 23, 1983, IGBE closed its operations, leaving behind at least

13,000 customers who lost approximately $72 million. William and James Alderdice are awaiting trial on federal charges in the Southern District of Florida and, in addition, face indictments by New York State. They indicated they would take the Fifth Amendment if called to testify at the Subcommittee's hearings.

Between November 1979 and April 1983, William L. Alderdice acted as President and Treasurer of IGBE and James D. Alderdice served as Vice President and Secretary of IGBE. During this time, IGBE was engaged in a business of soliciting orders from customers throughout the United States for the purchase and delivery of gold, silver and other precious metals. Its sales personnel lured thousands of investors throughout the country to invest more than $140,000,000 in gold and silver bullion which, the promoters represented was to be safely stored in the company's own vaults. In actuality, the vault in which IGBE was supposedly safekeeping millions of dollars worth of bullion sold to investors was virtually empty.

The indictment by the grand jury in the Southern District of Florida charges that the Alderdice brothers were engaged in a scheme to defraud the public through false representations and promises in order to induce customers to do business with IGBE and to maintain the flow of cash into the corporation. The indictment alleges that the Alderdices intermingled corporate funds; neglected to purchase metals at or near the time of receiving money from customers; failed to ship metals in a timely fashion; engaged in stalling and delaying tactics; failed to maintain adequate vault inventory; failed to protect customers' hedging in the futures market; misrepresented that IGBE was actively mining its own precious metals; shipped out metals sent in by customers for storage and safekeeping; and diverted, secreted and dissipated the assets of IGBE through a pattern of extravagant expenditures and reckless mismanagement contrary to representations made to and the appearance presented to customers, and in callous disregard for the security of customers' purchases.

IGBE is presently involved in federal bankruptcy proceedings. Earl Faircloth, the IGBE trustee in receivership, has determined that approximately $500,000 to $700,000 would be necessary to conduct a full audit of IGBE's books and records. He has been able to recover less than $500,000 in assets from his efforts on behalf of the company.

(3) JVF Investments, Inc.

About May 1982, 21-year old James V. Fanning formed JVF Investments, Inc. (JVF) to sell gold and silver through a one-year leverage-type program. Fanning, a former Universal Precious Metals salesman, hired other former salesmen and several of his family members. In January 1983, a federal court order requested by the CFTC stopped the firm from continuing to sell metals contracts. By that time, losses to 180 customers totalled approximately $1.5 million. Although the Palm Beach County State Attorney charged Fanning with fraud and grand theft, the suit was later dismissed because the state couldn't prove criminal intent. The state estimates that $30,000 to $40,000 would have been required to conduct the necessary audit. The FBI conducted an investigation in early 1983 for mail fraud, wire fraud and conspiracy, but the Assistant U.S. Attorney in West Palm Beach has not sought an indictment.

(4) United Precious Metals

In October 1983, United Precious Metals (United) in Miami filed for reorganization under Chapter 11. United sold gold and silver under delayed-delivery contracts. Investors would be offered a below-wholesale price for the metal in return for waiting 12 to 15 weeks for delivery. The company apparently did not purchase gold or silver immediately to cover sales to customers, and suffered substantial losses in futures trading. Trustee in bankruptcy Dan Bakst say 3500 customers lost approximately $3.5 million. Both Florida and New Jersey have issued cease and desist orders against the firm. New York State has also been conducting an investigation.

(5) Universal Precious Metals

From April 1981 to December 1982, Universal Precious Metals (UPM), was operated by sales manager Jack Rose and president David Bentley. Pursuant to UPM's business and its "leverage purchase program," customers could purchase or sell delayed delivery bullions and coins. The Fort Lauderdale company was raided by FBI agents in September 1982 and agreed to close that December after pressure from the CFTC. The company left approximately 580 customers with losses of $5.8 million in the aggregate. A suit filed by the CFTC alleging over $2 million in losses has been settled as to Rose upon his agreement to pay $50,000. The case has not been settled as to Bentley. The court-appointed reciever, William Nortman, estimates that customers will receive a small fraction of every dollar invested. No federal suits are pending, but New York State officials are investigating. Both Bentley and Rose indicated to Subcommittee staff that they would take the Fifth Amendment if subpoenaed by the Subcommittee.

II. Role of Various Agencies

One of the primary reasons that precious metals fraud perpetrators have succeeded in bilking over 40,000 customers out of more than $125 million is that con artists have carefully chosen an area of commodity investment fraud where jurisdiction by federal and state regulators and enforcers is unclear. Blame for the tragic losses lies with the scam artists. But the inactivity and shirking of responsibility by federal and state authorities and others cannot be ignored.

Presently, retail sellers of precious meals for cash are not required to be registered by either state or federal law. However, our investigation indicates that, in most instances, the actual sale is not one of precious metals for cash and that several federal regulators considered accepting jurisdiction but failed to do so. Similarly, state and federal criminal prosecutors (with some exceptions) should have more vigorously pursued precious metals swindlers. In addition, state regulators have not moved quickly which would enact legislation to facilitate prosecution of such cases.

The following section details the role played by various entities in attempting, or refusing, to deal with instances of precious metals fraud and in preventing such fraud in the future.

A. Consumer Protectors

For a number of reasons, consumer protectors such as local and state consumer affairs offices and Better Business Bureaus often are virtually powerless to alert investors to the dangers of precious metals investment transactions. First, precious metals scams are run in such a way that there are few, if any, unhappy customers in the initial stages of the operation, which is typical of a Ponzi scheme.

Secondly, scam artists usually solicit out-of-state customers so that there are no local complainants. In addition, when a complaint reaches consumer protection agencies, precious metals dealers generally act quickly to satisfy the complaining customer. Thus, checking with consumer protection agencies is, at best, a waste of time. More often it is worse in that it creates an illusion of safety.

During the period January 27,1983 to April 5, 1983 the Broward County Consumer Affairs Division, which is located in Fort Lauderdale as was IGBE, received approximately 150 customers complaints, all of which it forwarded to the FTC. While the Division was successful in helping customers recover some losses at first, during the final weeks of IGBE's business, IGBE was unresponsive to the Division's requests.

The potential harm to investors by a different type of "consumer protector", namely the investment financial adviser, may be even greater. While gold experts Dan Rosenthal and Howard Ruff initially endorsed the operations of Bullion Reserve in their newsletters, later they sounded a warning to investors which caused a rush of customers to liquidate their holdings. At least the actions of two other advisers, Jerome F. Smith and Sid Barlow are relevant. Smith, who is located in Costa Rica and is supposedly one of the nation's leading investment advisers in gold and silver, was paid an undisclosed $5,000 by Bullion Reserve for a personal endorsement of the precious metals dealer just about 5½ weeks before it closed its doors. That endorsement--in the form of a four page letter sent to about 90,000 precious metals investors, including about 33,000 Bullion Reserve customers--is estimated by industry sources to have led to hundreds of thousands, if not millions of dollars, in investor losses. Sid Barlow, a radio investment adviser on Station KIEV in Los Angeles, allegedly received payments from BRNA for each customer who invested in BRNA based on his recommendation of Bullion Reserve.

B. Advertisers

Precious metals scams are also lent an air of respectability by -advertising in reputable national newspapers and magazines. For example, both IGBE and Bullion Reserve advertised widely in national publications. While publications cannot be expected to vouch for the legitimacy of each advertisement they accept, they should develop policies for scrutinizing precious metals ads and should be quick to terminate contracts with precious metals dealers when notified of serious customer complaints.

C. State Regulators and Enforcers

1. Jurisdiction

The grant of exclusive jurisdiction over commodities enforcement to the CFTC under the CEA in 1974 forced a number of states to repeal or ignore their commodity statutes. In addition, it created a certain degree of animosity on the part of state enforcement officials who were left with few tools to enforce commodity-type fraud and who repeatedly saw the failure of the CFTC to step into the resulting gap.

Subsequent amendments to the CEA increased the degree of state authority, but it was not until the Futures Trading Act of 1982 that state enforcement actions were encouraged. The legislation authorized state officials to bring an action in state court to enforce the CEA against any person registered with the CFTC. Section 12(e) also provided for an "open season" on off-exchange commodity fraud under which State Attorneys General and Securities Administrators, for example, are authorized to take action either in court or administratively against persons selling off-exchange commodity investments, including precious and strategic metals. Section 12(e) explicitly permits the application of other federal and state laws to activities and persons who unlawfully engage in commodity transactions outside the Act's regulatory structure. Likewise, an action could be brought against any person engaged in an activity requiring registration or designation by the CFTC who has not complied with those regulations.

2. Legislation

At the time "open season" jurisdiction was granted, states could have acted quickly to fill any legislative gaps that prevented their adequate policing of off-exchange commodity fraud. The only regulatory tools available to most of the states at that time were their securities laws and general criminal or civil antifraud laws.

One year later, in January 1984, representatives of the North American Securities Administrators Association (NASAA), the National Futures Association (NFA) and the CFTC met to begin to draft model uniform state legislation dealing with off-exchange commodity-related investments, including leverage-type contracts and deferred delivery contracts involving gold, silver and other precious metals. Once the legislation is drafted, it must be approved by NASAA's membership, which is to meet in the fall of 1984. Passage of the legislation would then be left to each state, which will require time and will undoubtedly create a "patchwork" effect of states which adopt legislation.

Meanwhile, a number of states have proposed legislation to provide them with additional enforcement weapons. For example, in New York, one bill would require promoters of investments in precious metals or other commodities to register with the State Attorney General. A second bill would effectively prohibit boiler room operations by unregistered persons. A third New York proposal would require delivery or segregation under stringent financial requirements by vendors of precious metals. Similarly, Florida has proposed legislation which would prohibit "boiler room" sales activity relating to any investment in anticipation of economic benefit.

3. Enforcement

a. The Enforcers

Normally, the criminal prosecution of in-state fraud falls to the local State Attorney's office. State securities administrators are responsible for enforcing state securities laws and generally are restricted to civil penalties. In New York, the two are combined in the Bureau of Investor Protection and Securities in the Office of the Attorney General.

b. The State Enforcement Advantage

Many argue that local and state law enforcement agencies and securities administrators are in a much better position than are federal regulators to detect, investigate, and prosecute boiler room operators because of their proximity to the operations themselves. They argue that the tell-tale signs of boiler room scam artists, e.g., leases of large amounts of space, rental of office furniture, orders of extraordinary numbers of telephones, entries in local newspapers of ads promising large commissions for sales people, and huge deposits of money through local banks, should warn local law enforcement officials that a boiler room operation is in existence, even before there are customer complaints.

c. State Enforcement Problems

A number of problems hamper state and local law enforcement officials in their attack on precious metals fraud. As with consumer protection agencies, officials often can only react after great losses have occurred, when consumer complaints begin to surface. On-site law enforcement agencies often argue that they cannot act unless they have local complaints, and boiler room operators craftily focus their attention on out-of-state investors.

Secondly, many states currently do not have the statutory tools needed to begin an aggressive enforcement program against these types of frauds. While most states have general anti-fraud statutes, off-exchange transactions often are structured in a way that makes it difficult for state officials to prove a case of fraud. For example, most fraud statutes require a showing of intent that can be difficult to establish. Securities administrators often have difficulty convincing a court that a delayed delivery or leverage contract is a security under state securities laws.

Resource and manpower problems also daunt state enforcers. Adequate audits of the books of "precious metals" firms are expensive; an audit of IGBE is estimated to cost $500,000. Local state attorneys offices very often do not have the prosecutors and investigators necessary to police complex cases. Off-exchange cases often are so complex that they take years to investigate and bring to trial.

Finally, very often the most that state securities enforcers can hope to accomplish is to put boiler room operators out of business temporarily through use of injunctive or administrative orders. This does not adequately solve the precious metals fraud problem, because principals and salesmen inevitably move on to other boiler rooms.

d. Progress by State Enforcers

A number of states have taken advantage of expanded state jurisdiction in the off-exchange commodity area. For example, the New York State Attorney General's Office has gone after boiler rooms with a vengeance. Its tough state laws allows its Investor Protection Bureau and Securities to investigate and prosecute criminal as well as civil cases. New York obtained thirty criminal convictions against principals and salesmen of the Mineral Resources Corporation in one of the largest prosecutions of a boiler room operation ever undertaken by state or federal authorities. In July, 1983, the New York Attorney General obtained a multi-count felony indictment against the principals of IGBE. Later last fall, and before it even had consumer complaints, New York began an investigation of Bullion Reserve stemming from advertisements on a New York radio station. Presently, the New York State Attorney General's office presently has under investigation a number of other gold and silver commodity investment firms.

The Florida State Comptroller has adopted an aggressive posture in using securities laws to close boiler rooms selling precious metals and oil and gas leases. Seventy boiler rooms are currently under its investigation, three-fourths of which involve off-exchange commodity fraud and precious metals.

Other states, including California, Arizona and Colorado, are moving to close down precious metal boiler room operations as they spring up in their jurisdictions.

Cooperative efforts among the states appear to be at an all-time high and can be attributed in large part to the activities of NASAA. For example, NASAA's Special Projects Committee recently approved providing California with resources and staff from other states to assist in a special project to crack down on companies selling off-exchange contracts in California. California has subpoenaed books and records of approximately twenty precious and strategic metals dealers in that state.

In some instances, states are working to obtain multiple indictments against perpetrators of precious metals fraud, thus making defendants more likely to accept a plea, which avoids costly complex trials.

D. Federal Agencies

The losses incurred by defrauded investors in precious metals have been great in part because of the failure of federal regulatory agencies to take any action to stop the scam artists or to alert the investing public to the dangers the companies pose before they collapse. For example, although the CFTC, the SEC and the FTC were investigating IGBE and BRNA months and in some cases years before the companies failed, none of these agencies took enforcement action against them. The agencies maintained either lack of jurisdiction or lack of manpower to explain their conduct and their continued relative inactivity with respect to precious metals fraud firms.

1. Commodity Futures Trading Commission

a. Jurisdiction

Jurisdictional limits as to the definition of a "contract of sale of a commodity for future delivery" are set forth in section 2 of the Commodity Exchange Act (7 U.S.C. 82). Commodity options and leverage contracts also fall within the jurisdictional purview of the Act. (7 U.S.C. 6c and 23a). However, in defining the term "future delivery", the Act specifically excludes cash sales of a commodity for delayed or deferred delivery. In pertinent part, section 2 of the Act states:

> "The term 'future delivery' as used in this chapter, shall not include any sale of any cash commodity for deferred shipment or delivery."

Deferred shipment, cash sale commodities are commonly referred to as forward contracts. Authority to regulate hinges on the distinction between a forward or cash contract and futures contracts. Futures involve standardized contracts for purchase or sale of a commodity, which provide for future, as opposed to immediate, delivery and generally are secured by earnest money, or margin. Futures contracts are entered into primarily for the purpose of shifting risk on a change in the values of commodities, rather than for transferring ownership of the actual commodity. It is not expected that actual delivery of the commodity will ever occur. Indeed, most parties to a futures contract extinguish their legal obligation to make or take delivery by off-setting their contracts with equal and opposite transactions prior to the date of delivery, and accepting a profit or loss for any differences in price between the initial and off-setting transactions.

Sale of a commodity for deferred (forward) delivery covers only contracts which are entered into with the expectation that the delivery of the actual commodity will occur. The seller necessarily has the ability to deliver and the buyer would have the ability to accept delivery in fulfillment of the contract. Agricultural commodities are frequently traded this way.

Thus, there are major regulatory differences between outright cash sales, deferred delivery contracts and futures contracts. See In re: Stovall (1977-1980 Transfer Binder) Comm. Fut. L. Rep. (CCH) PP 20, 941 (CFTC Dec. 6, 1979).

In the meantime, marketing methods for precious metals have tended to put such transactions into a jurisdictional twilight zone. The CFTC is reluctant to assume jurisdiction, even in the event of fraud, in connection with the cash sale of commodities for deferred delivery, unless other facts change the nature of the transaction. And when the money is exchanged "up front" it is difficult to establish a basis on which to establish CFTC authority. See Commodity Futures Trading Commission v. Petro Marketing Group, 502 F. Supp. 866, aff'd 680 F. 2d 573.

Notwithstanding the statutory foreclosure of CFTC jurisdiction, there are two other possible avenues for assuming jurisdiction: (1) commodity advisory services and (2) leveraging.

(i) Commodity Advisory Services

Prior to the enactment of the Futures Trading Act of 1982, persons rendering advice as to the value of or to the advisability of trading in a cash commodity were regarded as "commodity trading advisors". Classification as such triggered registration and reporting requirements. Advisors were also subject to anti-fraud rules. 7 U.S.C. §2, 5m, 6o(1) (1976). Therefore, prior to January 11, 1983, the CFTC had jurisdiction over firms rendering advise in connection with their forward cash contracts in precious metals. Language contained in the commodity trading advisors anti-fraud provisions is broad:

> It shall be unlawfull...
> (a) to employ any devise, scheme or artifice to defraud any client or participant or prospective client or ...
> (b) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client... prospective client...
> 7 U.S.C. §6.

Actionable violations would include (1) failure to register as an advisor; (2) failure to deliver commodities as promised or according to contract; and (3) mis-statements as to any material aspect of the plan such as the purposes to which the customer's funds are used, reasons for the delayed delivery, storage of precious metals, financial soundness of the company or the expertise of its employees.

Even though an advisor as to the value of cash commodities no longer falls within the statutory definition of commodity trading advisor, pre-1983 events are still actionable under the federal savings statute, 1 U.S.C. §109 Warden, Lewisburg Penitentiary v. Marrero, 417 U.S.653, 659-660.

(ii) Leverage Contracts

Commodity transactions involving delayed delivery, particularly with respect to precious metals, deserve scrutiny as a so-called leverage or margin account transaction. Section 19 of the Act prohibits leverage or margin accounts transactions for gold and silver bullion or coins under standardized contracts (7 U.S.C. §23) It is arguable that a cash forward contract providing a rebate or significant interest payments for delay of delivery beyond the designated date constitutes a leverage transaction. By circumstance, then a cash forward contract in precious metals can be converted into a margined or a leveraged account. The Commission is constantly forced to look beyond form to the substance of a transaction to determine its jurisdiction. This is particularly difficult in the case of leverage contracts which have enjoyed a curious niche in the realm of commodity investment devices for years. See Breyer v. First National Monetary Corp. 548 F. Supp. 955 963-966 (1982). The CFTC has always had grave reservations about opening the "leverage industry" to new entrants but this may now occur since Congress has required the Commission to promulgate regulation governing leverage.

As the Subcommittee pointed out in 1982, "perhaps the greatest regulatory shortcoming of the CFTC is in the area of leverage transactions". In 1974 the CFTC was granted exclusive responsibility to promulgate regulations. Ten years later, on January 16, 1984, the CFTC set out regulations which limit the CFTC's jurisdiction to leverage contracts lasting ten years or more. 49 Fed. Reg. 5498 (Feb. 13, 1984). Before now, of course, the CFTC should have been policing firms which sold leverage contracts in violation of the CFTC's 1978 moratorium on leverage transactions, and it has been argued that both BRNA and IGBE were at some point selling leverage. But since "leverage" was and is such a nebulous concept, it is difficult to conclude that the CFTC had leverage anti-fraud jurisdiction.

On the other hand, the CFTC arguably has jurisdiction over sale of precious metals (or other commodities) when investors choose not to take delivery but to store the item for a fee in a place provided by the seller. If there is a buy back or liquidation provision in the contract, it may be said that the investor is speculating on the future value of a commodity and does not expect delivery.

b. Enforcement.

The following summarizes the involvement of the CFTC's Enforcement Division and the CFTC's subsequent decision not to take enforcement action in the two largest precious metals failures of 1983, IGBE and Bullion Reserve.

(i) IGBE

On September 8, 1980, the CFTC began an official preliminary inquiry into the actions of IGBE. In July of 1981, the Commission voted to conduct an investigation to determine whether IGBE or its affiliates had violated certain provisions of the CEA. Thereafter, pursuant to subpoenas issued to IGBE and a brokerage firm, the CFTC had access to IGBE's advertising material, customer contracts, employee information and brokerage statements, yet no enforcement action was taken.

On January 11, 1983, the new statutory definition of commodity trading advisor became effective. Immediately following, the CFTC Enforcment Division issued a memo summarizing the CFTC's IGBE investigation, which stated, among other things that, prior to January 11, 1983, the CFTC had jurisidiction over IGBE's cash business, could have required registration by the firm as a commodity trading advisor, and could have prosecuted IGBE for fraud. The memo went on to state that, due to the January 1983 definitional change, the CFTC now lacked jurisidiction. In a subsequent memo the CFTC's general counsel concluded that the CFTC could continue to investigate and charge IGBE with violations that occurred prior to January 1983. The Commission finally determined in March 1983 not to seek equitable or administrative remedies and to continue to coordinate efforts with other agencies as part of a multi-agency task force. CFTC officials worked during this two year period to alert other agencies to the IGBE problem, but no multi-agency task force was ever established and investors continued to pour money into IGBE.

(ii) BRNA.

To explain the CFTC's lack of action with respect to BRNA, Chairman Phillips has stated that the CFTC never got any customer complaints, that none of the people in the firm were registered with the CFTC and that the CFTC had not had any contact with them.

Yet, Subcommittee investigators have discovered that BRNA was not an unknown quantity to the CFTC. For example: (i) Alan Saxon applied for registration as a CTA on March 16, 1982, a principal of North American Commodity Reserve in November 1982 and as an associated person in August 1983; (ii) the CFTC's Division of Enforcement was concerned about Bullion Reserve's sales program as early as April 1, 1983, i.e., about six months before Bullion Reserve's collapse; and (iii) BRNA was filing reports with the CFTC as late as March 1983 which stated that the firm was trading gold and silver futures contracts for hedging purposes.

Unfortunately for thousands of customers, BRNA business continued to most resemble a contract for deferred delivery--an area in which the CFTC is precluded from acting.

c. Problems with Enforcement

The CFTC explains its lack of enforcement action against many precious metals scam artists by pleading lack of jurisdiction or lack of manpower. The CFTC cannot be made a scapegoat for every failure of a telephone sales firm just because the public was being sold a "commodity". As noted below with respect to the SEC, each contract must be individually analyzed; some present the CFTC with jurisdiction--many do not.

Moreover, manpower is obviously a major problem. The Commission has approximately 100 enforcement staff, and, of those, only 9 lawyers and investigators are assigned to the Southeastern United States east of the Mississippi and south of the Mason-Dixon line. To make matters worse, the Chicago regional counsel and a significant number of the Chicago staff have resigned in the last few months.

Hence, as with the SEC, it cannot be concluded that the CFTC had a clear mandate to police either BRNA or IGBE and, indeed, it moved against Universal Precious Metals. It is unfortunate that the Commission was not able to rally support for a concerted investigation of BRNA or IGBE by other authorities with obvious jurisdiction prior to those firms' collapse.

d. Progress

(i) Leverage Regulations

The regulations set out by the CFTC on leverage contracts which become effective in April state that those transactions that do not meet the Commission's definition of a leverage contract are not within the Commission's regulatory jurisdiction. Leverage contracts as defined by the regulations are ten year or longer contracts to buy specific quantities of gold, silver or other precious metals on credit. Now that the Commission has determined which transactions are subject to exclusive Commission, other so called "leverage" transactions are open to regulation and enforcement by the states.

On February 21, 1984, by complaints filed jointly by the CFTC and the State of Arizona, Smythe-Wheatley, Ltd. in Dana Point, California was enjoined from violations of the CEA that allegedly arose from the company's sale of long term leverage contracts and contravention of the CFTC's moratorium on new entry into that industry. CFTC officials say they expect to bring additional complaints against similar firms in the southwest soon.

(ii) Committee on Cooperation

The CFTC recently formed an Advisory Committee on CFTC-State

Cooperation to serve the needs of state and federal law enforcement agencies and to provide them with technical and legal assistance regarding commodity related investigations and prosecutions. Additionally, the unit will attempt to coordinate information sharing and enforcement referrals to various state and federal agencies, to conduct seminars, conferences and training sessions for state and federal law enforcement officers, and to assist those agencies in developing legislation and regulations to deal with commodity-related issues.

2. Securities and Exchange Commission

a. Jurisdiction

Given the sweep and power of the federal securities statutes, unscrupulous precious metals merchants have gone to great lengths to devise sales literature which purports to skirt Securities and Exchange Commission jurisdiction. However, investigation has shown a distinction between the actual method of operation and the advertised method.

If the activities of a firm, taken as a whole, constructively fall within the definition of a security, a series of protective reporting and disclosure requirements intended to benefit investors is triggered.

i. Definition of an Investment Contract

An investment contract is included within the definition of a "security" under Section 2 of the Securities Act of 1933. Later, the Supreme Court in SEC v. W.J. Howey, 328 U.S. 293 (1946) set down a three-pronged test to determine the presence of an "investment contract". An investment contract is: (i) an investment of money; (ii) in a common enterprise from which one is led to expect profits; (iii) solely from the efforts from others. Since the underlying statutory purpose is remedial, the definition is designed to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. The term investment contract is meant to be flexible rather than static, capable of counteracting the countless schemes calculated to lure investors money. See Timmreck v. Munn, 433 F. Supp. 396; (D.C. Ill. 1977); Sinva Inc., v. Merrill Lynch, Pierce Fenner & Smith, 253 F. Supp. 359 (D.C.N.Y. 1966).

Moreover, in determining whether a particular transaction qualifies as an investment contract, courts will look through form to the economic realities of the situation. When applying the three part test, courts also have avoided a literal approach, and have been careful not to attach undue significance to labels used by the participants in the transactions. Nash & Associates, Inc., v. Lum's of Ohio, Inc., 484 F.2d 792 (C.A. Ohio 1973).

In furtherance of this realistic and functional approach toward finding an investment contract, courts have examined the whole economic relationship between the investor and the seller. And subsequent case law has given a permissive rather than a restrictive reading to the "solely from the efforts of others" component of the Howey test. The Ninth Circuit held in S.E.C. v. Glen Turner Enterprises, Inc., 474 F.2d 476 (1973), cert. denied., 414 U.S. 821 (1973), that "solely" is not to be taken literally, but rather interpreted to mean "essential managerial effort."

Commonality of enterprise, the second element of the Howey test, has been subject to close court scrutiny. Essentially, there are two types of commonality: verticle and horizontal. The vertical relationship is defined as one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties. SEC v. International Mining Exchange, Inc., 515 F. Supp. 1062 (D.C. Colo. 1981). The horizontal approach is one in which the single investor's money is pooled with other investors - a pool of capital used in furthering a common enterprise. Curran v. Merrill, Lynch, Pierce, Fenner and Smith, 622 F.2d 216 (6th Cir. 1980); Hirk v. Agri-Research Council, Inc., 561 F2d 96 (7th Cir. 1977). Either a verticle or horizontal commonality have met the common enterprise requirement for an authentic investment contract.

Finally, in SEC v. Joiner Leasing, 320 U.S. 344 (1943) the Supreme Court observed that: "Novel, uncommon or irregular devices whatever they appear to be, are... reached if it be proved as a matter of fact that they were widely offered or dealt in under terms of course of dealing which establishes their character in commerce as investment contracts..."

ii. Precious Metals Sales and Investments

Plainly, the mere sale and delivery of a precious metal cannot be considered a securities transaction. Nor can the sale of an "interest" in such tangibles be classified as a security. H.R. Rep. No. 1878, 73rd Cong., 2d Sess. at 39 (1934). Neither does the sale of a precious metal coupled with a storage agreement with later delivery constitute a security. Noa v. Key Futures Inc., 638 F.2d 77 (9th Cir. 1980). In that case, the defendant exercised no managerial efforts whatsoever and profits to the investor hinged upon market fluctuations in silver. No services were provided to the investor and the risk was contingent upon the price of silver in the spot market.

1. Services Beyond Execution of Purchase and Sale Orders

Recent failures of firms marketing interests in gold and other precious metals have brought to light the fact that their services to investors went far beyond ministeral functions. Services were not limited to the mere execution of purchase and sales orders.

a. Investment Advice

Crucial to the transformation of the straight sale of a commodity into an investment contract is the relationship struck between the seller and the investor. While purchasers of precious metals ran the spectrum of investor sophistication, most of these buyers were naive and necessarily relied on advice the company had to offer. Dealers frequently represented themselves as having expertise in metals commodities. Recommendations were made as to timing purchases, switching strategies among precious metals and coins, and holding positions to weather market flucuations. Some dealers couched advice in investment letters, while others used brochures to praise the merits of precious metals and to disparage other investments. Computerized quotes were available to track the latest movements in the market. All trumpeted the value of precious metals as a hedge against inflation. A key element of all investment advice and counseling was the retention of the proceeds of the investment with the dealer. Then the investor was played along through various dilatory tactics, until it was too late.

Thus, the financial fortunes of the dealer were contingent upon retention of investor funds regardless of swings in the market. Whether the investor knew it or not, his potential for profits was identical to that of the dealer. Keeping the investors' funds serviced the dealers funding to generate profits in other markets. As such, the advisory relationship combined with a pooling operation meets both the verticle and horizontal commonality element of the Howey and Curran tests. See: SEC v. Continental Commodities Corp., 497 F.2d 516; Savino v. E.F. Hutton & Co., 507 F. Supp. 1225.

b. Deferred Delivery

A common feature of the past operation of bankrupt precious metals dealers was a scheme of deferred delivery. Dealers attempted to hedge, cover or leverage their operations until the delivery date - usually 90 days or more from the date of purchase. Profits generated by such activity enabled dealers to sell to investors at "spot" price with reduced brokerage fee, commission or sale charge, or no charges at all. Better still, for the dealer, was the opportunity for storage in unsegregated accounts without charge to the investor. Dealers were only too ready for storage because it supported the pooling of funds and extended the opportunity for profit elsewhere. Thus, the investors' assets were at extended risk until delivery, but investors were not usually informed of this. The survival of an investment, together with other services and benefits connected with the investment were, as a practical matter, bound up with the success of the pooling operation. In a similar set of circumstances, the SEC found this to be the sale of investment contracts and obtained an injunction against violation of the Securities Act. SEC v. Western Pacific Gold and Silver Exchange Corp., No. LV 74-188 RDF (D. Nev. May 19, 1981).

A later case, Noa v. Key Futures, 638 F.2d 77 (1980) has served to confuse matters by holding that agreements to sell silver bars were not investment contracts since profit was not dependent on the managerial efforts of the sellers. The only risk shouldered by purchasers was the potential for insolvency during the 30-day delivery period. These facts are distinguishable from the set of circumstances in Western Pacific in both nature and degree, yet the Nevada District Court eventually lifted the injunction against Western Pacific. Unfortunately, the SEC decided not to appeal that determination, notwithstanding the fact that in Noa there was no delayed delivery discount. Nor should it be concluded from the Noa case that a delayed delivery discount sale funded by a pooling operation is not an investment contract within the purview of the Securities Act.

c. Debt Transactions as Investments

Schemes to delay the delivery of precious metals have come in various incentive packages. Some sellers paid 1½% interest on "rebate" on the metals until the purchaser called for the metals. Some gave the "rebate" from the date of the purchase while others were triggered after the 90-day delay delivery period, when the dealer wanted to keep the metals for a longer period. These payments were derived from profits on precious metals transactions during the delay period. Receipts given as evidence of ownership to the purchaser may indeed be considered as "evidence of indebtedness" and classified as a securities transaction. See: Zabriski v. Lewis, 507 F.2d 546 (10th Cir. 1974); Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075 (7th Cir.) cert. denied, 409 U.S. 1009 (1972).

b. Enforcement

(i) IGBE

The first official action taken with respect to IGBE by the SEC came on October 20, 1981. On that date, the Associate Regional Administrator of the SEC in Miami issued several interrogatories to William Alderdice, president of IGBE. The interrogatories requested descriptions as to the type of shares, units and interests offered by IGBE for the purpose of determining whether IGBE was in violation of anti-fraud or registration requirements under the Security Exchange Acts. While the information requested was promptly received by the SEC the SEC took no further action in the investigation for a period of over two years.

In the early part of 1983, several events caused the SEC to take a renewed interest in IGBE. From January, 1983, through the succeeding several months, the SEC began to receive numerous complaints from IGBE investors, attorneys for investors, Congressman, and Senators.

By January 24, 1983, the CFTC determined conclusively that it lacked jurisdiction in the matter and on March 2, forwarded documents to the SEC that were obtained during its investigation of the bullion company. One week later the CFTC informed the SEC that they intended to take no further action in the matter and suggested that the SEC had jurisdiction.

On March 14, 1983, in its first action since the issuance of the interrogatories in October, 1981, the SEC requested complainants' documents from the FTC for the purpose of determining whether its jurisdiction extends to IGBE's activities. Two days later, the staff from the SEC met with Alderdice and IGBE's Attorney to discuss the same issue.

A record indicating the opening of SEC's formal inquiry into IGBE was filed in the SEC March 22, 1983. That document, entitled "matter under inquiry", referred to the IGBE offering as an "investment contract" involving "evidence of indebtedness". The subject matter of the inquiry was classified as fraud in the offer and sale of securities and the tendering of unregistered securities.

March 25, 1983, was the date of SEC Miami's first comprehensive analysis of SEC's jurisdictional basis over IGBE's offerings. In an extensive intra-office legal memorandum it was concluded that the IGBE offer involved the sale of securities with the purview of the SEC's jurisdictional limitations.

Whether SEC intended to act upon this determination is unknown. Since IGBE was forced into receivership the SEC was precluded from pursuing the matter further.

(ii) BRNA

On October 5, 1983, approximately one week after Saxon's death, the SEC Seattle Regional office contacted SEC's Los Angeles office to inquire as to the latter's involvement in the Bullion Reserve matter. The Seattle Office had been alerted to the problem after it had received complaints from BRNA investors and correspondence from the Oregon Justice Department. Further, the Seattle Office advised the Los Angeles Office that the CFTC was not pursuing the matter and suggested that the offer may have involved a security within the SEC's jurisdiction.

The following day, SEC Los Angeles contacted California Department of Corporations Enforcement Division to discuss the jurisdictional issues. Although the California Corporation Official posited that the CFTC was without jurisdiction and that the offering also did not involve a security, the SEC in Los Angeles, which by this time was apprised of the specifics regarding the offering, was not convinced about either.

On October 13, SEC Los Angeles suggested that several elements of the BRNA scheme indicated that a security might be involved. For the purpose of gathering facts to aid in the determination of this issue, it was recommended that the SEC participate in Bullion Reserve's bankruptcy proceedings. Once again, on October 22, the Seattle Regional Office indicated to the Los Angeles Office its belief that an investment contract was present.

Although the Staff members of the SEC met with the CFTC January 27, 1984 to discuss jurisdictional issues, and during the meeting SEC counsel expressed his belief that a "strong argument" could be made for an investment contract, no formal analysis of the issue was ever made prior to a request by the Subcommittee. Perhaps this theory will be tested in some future case.

c. Problems

While the SEC states that precious metals transactions generally are commodity sales transactions and not within the SEC's jurisdiction, a memorandum prepared for PSI concedes that certain provisions in precious metals contracts may transform the sale into one of an investment contract, and thus a securities transaction. But, as the discussion above indicates, these individual cases are completely dependent upon their own factual circumstances. Thus, heavy commitments of manpower are usually required just to determine the threshold question of jurisdiction. This involves breaking new legal ground--a course which the Commission members are unlikely to favor.

3. Federal Trade Commission

a. Jurisdiction

For any deceptive practice or unfair method of competition in connection with the retail sale of precious metals, the Federal Trade Commission (FTC) has at least residual jurisdiction. Section 5 of the FTC Act as amended (15 U.S.C. 45 (a) (1)) states:

> "(a) (1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful."

The FTC Act was intended to afford a preventive remedy by stopping unfair methods in their incipiency. FTC v. Raladan 316 US 149; Ford Motor Co. v. FTC 120 F.2d 475, cert denied 314 U.S. 668.

Moreover, the FTC, in establishing a violation of the Act under Section 5, need not prove actual deception. Misrepresentations are condemned if they possess a tendency to deceive, Trans World Accounts v. F.T.C. 594 F.2d 212 (C.A. Cal. 1979). In addition, intent to deceive is not an element of a deceptive advertising charge. Nor is good faith or innocence of motive a defense to misleading advertisements. Warner - Lambert v. FTC 562 F.2d 749; cert denied 435 U.S. 950.

(i) Trade Regulation Rule - Mail Order

While any type of deceptive commercial practice, not otherwise exempt by statute, is captured under Section 5 of the FTC Act, the Commission has developed specific trade regulation rules in the interest of public protection. Power to specifically define a deceptive practice also comes within the jurisdictional ambit of the FTC. National Petroleum Refiner Assoc. v. FTC 482 F.2d 672 (D.C. Cir. 73) cert denied 415 U.S. 951; Sperry Hutchenson v. FTC, 405 U.S. 233 (1972). These trade regulation rules also serve as guidelines or ground rules for industry. During 1975, the FTC promulgated a Mail Order Merchandise Trade Regulation Rule 16 C.F.R. 435 (40 Fed. Reg. 51583, 1975). The Mail Order Rule set down what practices are considered deceptive and unfair. Failure to deliver and failure to deliver within a reasonable period of time are per se violations of the rule. Providing adequate means for purchaser redress as well as a buyer right to a refund is required in multiple delay situations.

(ii) Suspect Practices of Precious Metals Dealers

In some instances, customers have sent gold and silver to precious metals dealers and the company failed to pay for the received merchandise. But most of the violations appear to occur when the company routinely misrepresents the nature of its operations and its intentions regarding the delivery of ordered precious metals. For example, the companies have indicated that they had physical possession of substantial amounts of precious metals, when in fact they did not. Representations are made that orders would be shipped by a certain date when, in fact, the company has no intention to do so or knows, based on prior experience, that it would be unable to do so. Delay notices are never sent, nor are monies refunded after extended delay. All of this is in direct violation of the Mail Order Rule.

Telephone orders paid for by credit card or wire, while not covered under the Mail Order Rule, are cognizable under Section 5 of the FTC Act. And whether by phone or mail, a characteristic common to all of the recently failed precious metals dealers was a scheme of delayed delivery. Indeed, in most instances, their survival depended on it.

In the final analysis, the FTC had unequivocal jurisdiction over the sales practices of IGBE, Bullion Reserve of North America and other companies which have used similar marketing methods.

b. Enforcement

(i) IGBE

In April 1981, the FTC began an initial phase investigation of IGBE and, in July 1982, closed that investigation. Subsequently, in December 1982, another informal investigation was begun. During this time period, numerous federal and state investigators, the Miami Business Bureau and the U.S. Postal Inspector were sending IGBE customer complaints to the FTC. By April 1983, the FTC had received over 400 complaints.

In a memo dated April 1983, the FTC Chicago Office requested authorization to conduct a full phase investigation of IGBE. The memo indicated that information from IGBE customers and state and federal authorities, and copies of IGBE correspondence and advertisements, suggested that IGBE had made no attempt to comply with the FTC's Mail Order Rule and Section 5. In May 1983, the Chicago Regional Office recommended that the FTC authorize an action seeking a permanent injunction against IGBE and its principal officers for violations of the Commission's Mail Order Rule and Section 5 of the FTC Act. But by September 1983, the company was defunct and the FTC closed its investigation, according to an internal memo, because it "was no longer necessary to seek to prevent future deceptive sales practices and no longer practical to pursue consumer redress outside the (IGBE) bankruptcy proceeding."

(ii) Bullion Reserve

The FTC has stated to Subcommittee staff that its Chicago office opened an initial phase investigation of Bullion Reserve on May 9, 1983. This was apparently part of a larger survey of mail order gold and silver sellers to determine if there were any firms in the industry that may be using unfair or deceptive acts or practices in the offering for sale or sale of gold and silver.

The FTC closed its investigation in October 1983 "after learning that the (firm) was no longer in operation."

c. Problems

Unlike the CFTC and SEC which have stated that they believe they have no jurisdiction with respect to precious metal sales fraud, the FTC has acknowledged that, at least in particular cases such as IGBE and Bullion Reserve, the FTC did have jurisdiction but determined not to exercise it because of the substantial commitment of resources that would have been necessary to pursue the cases. The FTC also has stated that it is poorly equipped to deal with "hard core fraud" because of the FTC's protracted administrative discovery procedures, which are clumsy and typically require eighteen months to be litigated. A temporary restraining order in such cases as Bullion Reserve and IGBE was not feasible, according to the FTC, because the approval for a TRO application must come from the FTC Chairman, who requires a presentation of the underlying evidence. This requirement runs afoul of the FTC's lengthly discovery processes.

In addition, FTC staff told Subcommittee staff that the FTC is currently seeking to consolidate its jurisidiction by narrowing the matters in which it involves itself rather than expanding them. It says it has been concentrating its small enforcement resources on gas and oil lease fraud and gem dealers. With regard to precious metals cases, the FTC's current view appears to be that it would like to be part of a joint agency effort, but does not wish to take the lead in any such program.

4. Department of Justice

Clearly, the Justice Department has jurisdiction to investigate (through the FBI) and to prosecute (through U.S. Attorneys) precious metals fraud as possible violations of federal mail fraud, wire fraud and conspiracy statutes. Currently, an indictment against IGBE and its principals is outstanding in the Southern District of Florida. There are few, if any, other outstanding indictments of precious metals fraud perpetrators. Although the FBI declined to discuss with Subcommittee staff its commitment or lack thereof in pursuing precious metals fraud investigations in Florida, it is known that at least one investigation of a South Florida precious metals dealer emanated from FBI Chicago. Sources say that the South Florida FBI Unit may be reluctant to pursue precious metals investigations because the priorities of the U.S. Attorney lie elsewhere--namely, narcotics, money laundering, violent crime and firearms. Another source reports that the FBI is planning to close its fraud unit in Miami.

Stanley Marcus, U.S. Attorney in Miami, has told PSI that he anticipates increased prosecution in the area of fraud, especially boiler room fraud, in the next few months. Marcus told Subcommittee staff that, while statutes are adequate to prosecute boiler room fraud effectively, the cases are extremely time consuming and increased penalties would be useful.

In any case, criminal prosecution of boiler room operators is a critical part of any attempt to eliminate precious metals fraud and all such prosecutions cannot be left in the hands of the states. There is clearly an important federal prosecutorial role.

5. U.S. Probation Office

Of all the federal regulatory and enforcement entities, the U.S. Probation Office deals with the criminal defendant the longest. And yet, its participation in solving the problem is probably the most overlooked, perhaps because so few precious metals crooks have been convicted.

U.S. Probation Officers for the Southern District of Florida told Subcommittee staff that jail is the only significant deterrent to commodity fraud. They indicate that alternatives to incarceration are not successful. Restitution, for example, is not effective because boiler room operators are clever enough to transfer their assets prior to sentencing. For example, one well-known South Florida boiler room operator who has been previously convicted has, in the last five years, reportedly divorced and remarried the same woman two or three times. On each of these occasions the divorce was a vehicle for a sham transfer of assets to the wife prior to divorce so that the husband would have no assets at the time of sentencing.

Recently, the Southern District of Florida has instituted a program of special conditions of probation, including requiring the defendant to stay out of the boiler room business altogether. This may also be unsuccessful, probation officers say, because defense attorneys can argue that the individual is a salesman and can not make a living in any other line of business. Judges generally feel that any possibility of legitimate livelihood should not be forclosed from a defendant. In addition, even if such a special condition is imposed, often judges are unwilling to send a white collar violator back to jail for what is considered a "technical violation".

A number of problems hamper federal probation officers in their fight against high pressure sales fraud. For example, they do not have subpoena power or any effective means for discovering and disclosing defendants' assets and activities. Similarly, while probation officers regularly see defendants in white collar cases engaging in sham transfers of assets and other concealment, they are unable to conduct an effective investigation because of their lack of investigative authority. The South Florida officers also urge that sentencing guidelines promulgated by the federal judiciary be significantly stiffened in the area of white collar crime.

6. National Futures Association

The National Futures Association (NFA), the first nationwide self-regulatory organization for the futures industry, has certainly progressed beyond its "fledging stage" at the time of the Subcommittee's 1982 Report. Currently, it is quite actively referring possible off-exchange violations to state administrators, offering to provide audit teams requested by state securities commissioners, helping to draft the model state legislation dealing with off-exchange contracts, and providing commodity training sessions for state enforcement authorities.

III Conclusions and Recommendations

A. Conclusions

After a study of the problem, the staff has come to the following conclusions with respect to the fraudulent retail sale of precious metals.

(1) Precious metals fraud schemes are only one aspect of a larger problem, that of high pressure telephone sales fraud. It is likely that tougher regulation and more vigorous enforcement by federal and state authorities solely of precious metals fraud would only serve to drive principals and salesmen into other types of boiler room sales, e.g., oil and gas leases, real estate, novelty items, etc.

(2) The only effective way of diminishing precious metals or boiler room fraud is through criminal prosecution, stiff sentencing and subsequent adequate supervision of boiler room operators and salesmen.

(3) No one federal or state authority is capable of or should be expected to handle the problem of boiler room fraud alone. Cooperative efforts by consumer affairs, state, federal and self-regulatory entities are necessary to eliminate this growing problem and these entities badly need an imaginative, joint approach if further catastrophies are to be prevented.

B. Recommendations

(i) Expeditious drafting and passage of model state legislation to give states the tools to deal with off-exchange commodity related investments;

(ii) more vigorous investigative and criminal prosecutorial efforts by the Department of Justice and state authorities;

(iii) formation of an emergency multi-agency task force which could include representatives of the Department of Justice, CFTC, SEC, FTC, U.S. Postal Service, U.S. Probation Office, NASAA, NFA and State Attorneys General, the objective of which is to bring criminal prosecutions against fraud operators, thus overcoming nagging regulatory jurisdictional issues; and

(iv) public education and self-regulation by industry associations.

CHRONOLOGY OF CERTAIN FEDERAL AGENCY AND STATE LAW ENFORCEMENT KNOWLEDGE AND/OR ACTIONS REGARDING INTERNATIONAL GOLD BULLION EXCHANGE ("IGBE")

The following chronology of certain federal agency and state law enforcement knowledge of and/or action taken with respect to IGBE was compiled from a review of documents submitted to the Subcommittee by the CFTC, FTC, and SEC upon request and, as to dates in IGBE's corporate history, a review of certain newspaper articles.

1980

September 8	CFTC begins official preliminary inquiry.

1981

February 20	IGBE files application with CFTC for registration as a CTA.
April	FTC begins initial phase investigation of IGBE; FTC informed that Postal Inspector closing its investigation of IGBE.
May 13	Minnesota issues cease and desist order against sale of securities in Minnesota by IGBE.
June 1981	FBI-Florida begins IGBE inquiry.
June 25	CFTC Southern Regional staff attorney writes memo describing operations of IGBE, outlining jurisdictional basis for CFTC civil injunctive action and recommending that an action be filed for violations of § 4m, 4(1), 4(2) and 19 of the CEA and § 31.1 of the regulations.
June 26	CFTC grants FBI access to its files.
July 28	CFTC Division of Enforcement issues memo to the Commission seeking an investigation to determine whether IGBE has violated § 4m, 4(1), and possibly 4b of the CEA.
August 25	CFTC meets and votes to accept the recommendation of its Division of Enforcement to conduct an investigation to determine whether IGBE or its affiliates may have violated §4m and 4(1) of the CEA.
Summer	CFTC begins to receive "numerous complaints from IGBE customers".
September 2	CFTC issues subpoena to IGBE for advertising materials, customer contracts and correspondence, employee information, brokerage statements, etc.
Fall	CFTC's Assistant Enforcement Chief meets with FTC staff and recommends IGBE as candidate for FTC's new "investment frauds" program.
October	CFTC grants access to files to FTC, DOJ-Criminal Fraud.
October 9	CFTC's Enforcement Chief invites SEC-Miami to join in joint IGBE investigation and grants to SEC access to all investigative files concerning IGBE.
October 20	SEC Miami issues letter/interrogatories to Alderdice requesting information as to IGBE's shares, units, interests or other agreements offered, for the purpose of determining whether

	IGBE is in violation of anti-fraud and/or registration requirements.
October 21	Affidavit of W. Alderdice in response to CFTC subpoena issued September 2, 1981 outlines IGBE's offerings and certificates of deposit program.
December	CFTC receives information from FBI-Ft. Lauderdale office in regard to its investigation.
December 1	FTC makes request of IGBE regarding hedging procedures.
December 16	Letter from Alderdice to SEC's compliance examiner responds to SEC written letter/interrogatories directed October 20, 1981.
December 22	CFTC's Division of Enforcement issues subpoena duces tecum to Merrill Lynch et al calling for IGBE's accounts.
	1982
Early 1982	CFTC reviews documents produced by IGBE and Merrill Lynch and was "unable to determine that IGBE had engaged in any fraudulent activity under (their) jurisdiction".
January	CFTC scheduled depositions of Alderdices' postponed indefinitely due to federal grand jury subpoena.
April 7	In letter to Justice Department Fraud Section CFTC says that its investigation of IGBE has been delayed "as a result of the impanelling of a grand jury".
May	FTC informed that FBI closing its IGBE investigation.
July	FTC ends initial phase investigation of IGBE.
July 1	CFTC memo states probably no CFTC jurisdiction because IGBE has "cash forward" contract. Also says SEC and local prosecutor's office conducting an investigation and that DOJ-Fraud aware of IGBE ponzi scheme.
August 12	Following further customer complaints and an inability to determine if IGBE is engaged in fraudulent activity under CFTC's jurisdiction, CFTC issues a second subpoena to IGBE for materials relating to period September 1981-September 1982.
September 16	IGBE's attorney responds on behalf of Alderdice to CFTC subpoena duces tecum issued August 12, 1982.
November	FTC begins to receive IGBE customer complaints.
November 1 - 5	CFTC Division of Enforcement receives numerous calls from IGBE customers concerning delayed delivery.
November 4	CFTC Enforcement Division staff speaks with IGBE attorney who explains that delays in shipments were due to increased orders.

December	Florida AG begins IGBE investigation. FTC attorney conducts informal investigation of IGBE. Undated unsigned FTC memo states that attorney said his coworkers were somewhat neutral about IGBE, got busy on another case and thus, "never had time to pursue IGBE". Same memo states that FTC's DC office said FBI wanted FTC to take action against IGBE because FBI thought IGBE fell short of fraud.
Sometime in 1982	Grand jury issues subpoenas. CFTC Jan. 27, 1983 memo says issuance had adverse effect on CFTC investigation.

1983

January	CFTC's Enforcement Chief calls FTC's Consumer Fraud Director and urges intensified FTC investigaiton.
January 11	Effective date of Futures Trading Act of 1982 which restricted the definition of commodity trading advisor to only those persons who engage in the business of advising others as to value or advisability of trading in futures, options or leverage transactions.
January 17	CFTC staff speaks to Ft. Lauderdale FBI agent who indicates he received 7-8 complaints about IGBE per day since January 1, 1983.
January 19	FTC's Chicago office opens investigation of BRNA.
January 24	CFTC attorney issues memo summarizing CFTC investigation and stating, among other things, the Commission's (a) belief that IGBE contract is agreement for sale of cash commodity for deferred delivery (b) suspicion that at various times since May 1, 1981, IGBE may have engaged in fraudulent and deceptive practices and (c) belief that CFTC does not have jurisdiction to proceed with enforcement action. Memo also notes CFTC request of IGBE for documents relating to program which might involve a futures option or leverage contract. Memo reasons that in the IGBE arrangement ownership is intended to pass even though actual possession is delayed, and cited In re Stoval as supporting the proposition that in such a case the cash commodity exclusion is invoked. Memo further cited the dicta in In re Stoval "that parties to a futures contract do not usually expect delivery and it rarely occurs."
January 27	CFTC's Enforcement Chief Loughran issues memo to Chairman Johnson summarizing CFTC's investigation, jurisdictional problems, and other agency cooperative efforts. Memo states, among other things, that prior to January 11, 1983, CFTC had jurisdiction over IGBE's "cash" business, might have required registration by the firm as a commodity trading advisor and could have prosecuted fraud by the firm in the sale of cash contracts. He also stated that (a) the CFTC had expressed concern during 1982 reauthorization that § 201 definitional change

	would adversely affect the CFTC's ability to reach IGBE (b) the CFTC now lacks jurisdiction and (c) IGBE could collapse when it loses control of its ponzi scheme.
	FTC requests consumer complaints from various consumer protection agencies in Florida, Texas, and California.
January 31	In letter to CFTC, FTC says Chicago FTC office conducting inquiry as to possible IGBE violations of §5 of Federal Trade Commission Act and Mail Order Merchandise Trade Regulation Rule. Also, requests CFTC information and cooperation.
February 8	According to FTC February 8th memo, FBI conversation with Bill Alderdice indicated that (i) at any given time, IGBE is 20-50% hedged; and (ii) sometimes gold is not bought to meet delivery dates because price was disadvantageous to IGBE. FBI saw 200 salesmen and yet no packing or delivery employees.
February 9	CFTC's General Counsel memo to Chairman Johnson concludes that the CFTC may continue to investigate and charge with violations of CEA persons who, prior to January 11, 1983, engaged in activities requiring them to be registered as a CTA, and who in connection with those activities either defrauded others or were not registered, even though the same activities if conducted after January 11 would not require registration or be subject to the anti-fraud provisions of the Act. The memo also stated that it was unlikely that a cease and desist order would be granted or that a court would enjoin such conduct, but that other equitable relief might be obtained.
February 10	FTC learns not to expect a federal indictment.
Early March	SEC's Miami office requests that FTC send it information received from CFTC by FTC.
March 7	FTC makes written request of IGBE for information and material (IGBE ignores).
March 8	CFTC's Enforcement Chief calls DOJ Fraud Section which says DOJ does not yet have "probable cause" to move against IGBE.
March 9	CFTC's Chairman Johnson and Loughran meet. Loughran says that, in light of recent amendments to CEA, both federal equitable and administrative remedies seem fruitless. Chairman requests CFTC continue IGBE investigation as part of "multi-agency task force".
	Loughran talks to SEC's Enforcement Chief Fedders who reports SEC reviewing to determine if IGBE offering securities.
	Loughran writes Florida AG offering assistance.
	Memo of SEC telephone call to Loughran, Division of Enforcement of CFTC, indicates that Loughran said: (1) IGBE was selling gold on "cash contracts" and hence without the jurisdiction of CFTC, and (2) according to supoenaed records no "ponzi" or "float scheme" is apparent.

	Loughran, who previously served with the SEC, opined that IGBE was probably selling a security.
March 11	CFTC staff meet with DOJ-Criminal Fraud staff.
	Alabama Securities Commission issues temporary cease and desist order against IGBE for violations of security laws.
March 14	SEC Miami writes General Counsel FTC for the purpose of determining whether IGBE is offering a security and requests all information provided to FTC, and in particular FTC's Chicago office, by complainants of IGBE.
March 16	CFTC begins to collect consumer complaints in order to advise state attorneys general as to IGBE acitivities if other agencies do not act against IGBE in next few weeks.
	Confirmatory letter of March 25 reveals that the staff of SEC met with IGBE's Alderdice and Clodfelter on March 16, whereupon an invitation to visit IGBE's office and review its records was extended. Letter states that meeting was scheduled for April 4.
March 21	Illinois issues temporary order to prohibit sales of securities in Illinois by IGBE.
March 22	CFTC's Enforcement staff meets with FTC to discuss IGBE. In March 23 memo, CFTC discusses, among other things, (a) CFTC view that IGBE complaints seem better suited to FTC statute, (b) FTC's interest in DOJ involvement and concerns about FTC civil remedies, and (c) CFTC investigators' determination one year earlier that documentation of IGBE ponzi scheme would requrie "4 or 5 weeks of detailed analysis".
	Unsigned "MATTER UNDER INQUIRY" document reflects the opening of the SEC's inqury into IGBE and indicates; (1) the disposition of the IGBE inquiry as pending; (2) the nature of the security as being a investment contract, and; (3) the classification of the matter as being both "fraud in offer/sales securities" and "unregistered offering". Further, document states "subject company buys and sells metals to public in form of investment contract and evidence of indebtedness".
March 24	Meeting at DOJ-Fraud of FTC, Chicago USA, FBI, and CFTC officials. CFTC's memo of March 24 indicates that CFTC representatives concluded that DOJ had highlighted IGBE for possible criminal prosecution. FTC's May 26 draft memorandum states that CFTC and SEC indicated they did not plan to reopen investigation.
March 25	Extensive intraoffice D.C. SEC legal memo concludes that the IGBE programs represent offers and sales of securities as investment contracts and evidences of indebtedness.
	Miami SEC writes IGBE attorney to confirm the attorney's statement to Alderdice that IGBE's operations did not constitute the offer and sale of security.

March 30	Florida AG files complaint against IGBE for violations of Florida consumer protection laws and issues an emergency order to cease and desist for violating Florida's Deceptive and Unfair Trade Practices Act.
March 31	Illinois Secretary of State enters into consent agreement with IGBE and Alderdice which includes promise to deliver to Illinois residents metals due (IGBE failed to comply).
After March 30	Myriad complaints are received by SEC/Washington from IGBE investors concerning IGBE's failure to pay checks and tender delivery on coinage. Inquiries are also made from Congressmen Long, De La Garza, Zablocki, Hall, and Senators Chiles and Kennedy. SEC requests that investors direct their correspondence to Florida A.G.'s office as the IGBE's transactions fall outside the scope of SEC's jurisdiction.
April 8	IGBE verbally agrees with New York AG to stop selling in New York.
April 11	New York AG signs agreement with IGBE temporarily barring its selling in New York. FTC has received over 400 complaints against IGBE.
April 13	Florida Comptroller files injunctive securities action under Blue Sky statute against IGBE for sale of unregistered securities.
	New Jersey issues cease and desist order for securities violations.
April 19	Alabama issues permanent cease and desist order to IGBE.
April 20	NASAA meeting in Washington. CFTC's memo says FTC admitted jurisdiction over IGBE-type conduct. FTC's April 20 memo states that FTC's attorney said he told state officials at NASAA meeting not to expect FTC to "jump out in front" on IGBE case; that any action, if taken, would be 2-4 months away.
	FTC's Chicago office requests authorization to conduct full phase investigation.
April 21	Florida judge issues TRO forbidding IGBE sales and closes IGBE upon request from Florida AG; California A.G. files consumer protection suit.
April 22	Illinois A.G. files consumer protection suit; TRO and freeze of assets obtained; court later appointed reciever.
April 25	Texas issues cease and desist order and temporary receiver is appointed.
April 27	IGBE files for Chapter 11 reorganization in Florida; Iowa AG alleges consumer fraud act violation and cease and desist order entered for Iowa security laws violations.
April 28	In memo to Enforcement Chief and all regional administrators, SEC Miami advises of the appointment of a receiver for IGBE and a TRO in Florida courts which gives IGBE until April 28 to file for bankruptcy.

May	FTC Chicago contacts a number of AG's regarding any action taken against IGBE.
May 4	Miami meeting of various federal and state enforcement agencies involved in IGBE investigations. CFTC's memo notes, among other things, (a) statistics re number of customers, employees, etc., (b) absence of funds and rumors of offshore banks, (c) suspicion of drug links, organized crime connections and laundered funds, (d) possible CFTC audit of IGBE affiliate.
May 5	In letter to Wyoming AG, CFTC says FTC appears to have jurisdiction over IGBE-type consumer complaints.
May 10	Ft. Lauderdale Police Department sets up investor complaint file for all IGBE clients.
May 26	FTC Chicago drafts memo recommending that the FTC seek a permanent injunction against IGBE for violations of the Mail Order Rule and § 5 of the FTC Act. The memo states that; (i) absent any pending litigation, the situation presents "an ideal candidate for injunctive relief, redress, and civil penalties; and (ii) given the pendency of existing civil and potential criminal actions, the need for FTC action is limited to insuring that IGBE remains closed or, if it does open again, that it comply with §5 and the Mail Order Rule.
June 15	U.S. Department of Labor requests payroll records of IGBE and Int'l Investment Bankers, Inc. thought to be in SEC's possession.
July	FTC ships 2½ file drawers of consumer complaints to Fort Lauderdale police department and recommends closing investigation because of the various criminal actions against IGBE as well as the likelihood of the bankruptcy petition becoming a Chapter 7 liquidation.
July 14	Alderdices arrested pending hearing for extradition to New York where grand jury indicted them for securities fraud and grand larceny.
August 4	Trustee in bankruptcy Faircloth seeks conversion to Chapter 7 liquidation.
August 16	Alderdices indicted by Federal grand jury on 18 counts of conspiracy, mail and wire fraud
September	FTC closes investigation of IGBE as it "was no longer necessary to seek to prevent future deceptive sales practices and no longer practical to pursue consumer redress outside the (IGBE) bankruptcy proceeding."

JURISDICTIONAL INDECISION OVER BULLION RESERVE OF NORTH AMERICA

The following chronology of actions or non-actions taken with respect to Bullion Reserve of North America was compiled from documents submitted to the Subcommittee, from various agencies.

1983

Spring	State banking regulators request interview of Alan Saxon in connection with his proposed acquisition of Commercial Bank of California. Regulators asked for but did not receive financial statements of Bullion Reserve.
August 19	Publication from BRNA to investors in response to commentator Rosenthal's article.
September 27	Bullion Reserve fails for the first time to meet payment deadline to Johnson-Matthew, Ltd..
September 28	Saxon dies. NY AG meets in NY with Richard Arfa, BRNA's in house counsel, and requests financial statements of BRNA within 24 hours.
October 5	SEC Seattle receives calls from investors in BRNA and from the Oregon Justice Department. SEC attorney states (a) that she thought SEC had jurisdiction based on SEC v. Western Pacific Gold and Silver Exchange Corporation et al; (b) that CFTC is not inquiring since it has no jurisdiction, (c) that CFTC said it would have jurisdiction if BRNA offered standardized contract with no obligation to make or take delivery; (d) that the California District Attorney is pursuing the matter.
October 6	SEC Los Angeles tells Enforcement Chief, California Department of Corporations that SEC Enforcement Chief's position was that no security was involved, that there was a straight sale of a product, and that the CFTC has no jurisdiction.
	Notes regarding literature mailed to customers by BRNA show the SEC (LA) was aware that BRNA offered: (a) total liquidity; (b) free insurance and storage; (c) a "member account" program which offered "security and profit", and; (d) 100% guaranteed repurchase at world spot prices. SEC was also aware that customers numbered between 30K and 35K, that monthly statements were issued to customers, that customers could buy on margin, and that customers were encourged to store metal in the Utah vault.
October 13	Los Angeles Times reports Rosenthal didn't go to the authorities in July since he wasn't "morally convinced" that fraud was involved until two weeks before Saxon's demise.
October 13	SEC (LA) outlines the status of the BRNA bankruptcy petition and states that the following facts indicate BRNA's certificate program may have involved the issue and sale of a security: (1) BRNA represented to purchasers that its "certificates" offered "total liquidity" and "security"; (2) BRNA guaranteed to repurchase the "certificates" at the world spot price; (3) purchasers were offered financing arrangements which would allow them to purchase with a 10%

	down payment; and (4) more facts are needed to make the jurisdictional determination and to this end recommended SEC's participation in bankruptcy proceeding.
October 22	SEC Seattle Attorney expresses her view that the deal involved an investment contract because of BRNA's "guaranteed repurchase agreement" and promise to "make a market".
October 24	SEC General Counsel states that the Commission is now investigating BRNA and asks for a staff attorney to "give some thought" as to whether BRNA scheme involves securities.
October 28	Correspondence from Oregon's Justice Department to SEC (LA) indicates that The Oregon Justice Department's Complainants file will be forwarded to SEC in compliance with SEC's, request.
October 31	SEC General Counsel requests an analysis of the jurisdictional issue by staff.
aft. Nov. 7	Staff of the branch of Corporate Reorganization of the SEC (LA), in reply to Congressman's Barnard's inquiry into the status of BRNA, issues report. The report stated inter alia: (a) that SEC (LA) currently has three complaint letters regarding BRNA and individual losses; (b) that it is questionable "whether BRNA's certificate program involved the offer and sale of a security"; and (c) that SEC's appearance of October 14, 1983, in bankruptcy proceeding was in part to aquire additional facts, particularly in regard to certificate program, to determine if jurisdictional bases exists.
November 9	Finance magazine reports Florida authorities claim deferred-delivery sales agreements are actually investment contracts.
November 14	SEC's General Counsel expresses concern over SEC's possible jurisdiction over BRNA. Requests that SEC develop a position in the matter.
November 23	Motion to convert BRNA from chapter 7 to chapter 11 is filed.
December 2	SEC's General Counsel is told that Florida A.G. is attempting to treat the scheme as investment contract. Resolution to call General Counsel of CFTC.
December 13	N.Y. Attorney General issues inquiry and directs that officers of BRNA and related entities appear for questioning.
	Upon New York Attorney General's motion put in order below an order is signed: (1) requiring BRNA's appearance on 1-27-84; (2) restraining sales or offers of sales of securities or commodities within or from N.Y., and; (3) enjoining BRNA, et al, from disposing of assets.
December 26	Order for conversion of cases from reorganization to liquidation is filed.

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January 26	SEC General Counsel writes SEC, Director of Enforcement re: responses to be made to PSI inquiry of January 24, 1983. SEC general counsel, in a memo directed to staff, asks for a determination of whether BRNA was operating under an investment contract scheme or was selling undivided interests in precious metal.
January 27	Meeting held with CFTC to discuss leverage contracts and the CFTC's exclusive jurisdiction. It was determined, among other things: (1) investigation of BRNA and IGBE has not resulted in an enforcement recommendation; (2) CFTC seeking to encourage SEC or state authorities to act because of limited resources and/or lack of jurisdiction, and; (3) SEC General Counsel believes that a "strong argument" could be made for investment contracts.

RECENT PRECIOUS METALS FAILURES

Company Name City	Date Closed	Creditors'* Claims (Est.)	Creditor* Losses (Est.)
United Precious Metals Inc. Boca Raton	Oct. 20, 1983	3,000	$3.5 million
Bullion Reserve of North America Los Angeles	Sept. 30, 1983	20,000	$60 million
International Gold Bullion Exchange Fort Lauderdale	April 21, 1983	13,000	$72 million
JVF Investment Inc. Boca Raton	Jan. 14, 1983	180	Not Available
Universal Precious Metals Inc. Fort Lauderdale	Nov. 10, 1982	580	$5.8 million
First Guaranty Metals Co. Miami	Jan. 30, 1980	700	$6.4 million

*Source: Trustees, Receivers and Escrow Agents.

Time for filing creditors' claims has not expired. Hence, number of claims and amount of losses could be higher.

PREPARED STATEMENT OF STANLEY MARCUS, U.S. ATTORNEY SOUTHERN DISTRICT OF FLORIDA

I want to thank you for inviting me to testify before this hearing regarding boiler room fraud in general and metals fraud in particular and the many federal law enforcement efforts which have been undertaken in the last 18 months to address this problem area.

Promoters call it telemarketing. Law enforcement personnel label it boiler room fraud. It starts with a voice on the telephone - convincing, sympathetic, sincere. Victims number in the tens of thousands and their losses surpass hundreds of millions of dollars. People may get "pitched" from Los Angeles, Dallas, Houston, New York City or Phoenix. Unfortunately, South Florida, with more than 100 phone rooms and twenty (20) to thirty (30) precious-metals trading companies alone, has become a hotbed of boiler room activity.

Of course, such activity extends beyond precious metals sales. Boiler room salesmen pitch anything and everything, ranging from oil and gas leases and land parcels to tax shelters to currency to industrial chemicals to charities to specialty and novelty items, like pens and calendars. But at least since 1978, gold and silver, platinum and copper have been king. And the kingdom for these sales has been Florida's Gold Coast.

Explanations for this phenomenon are varied. Certainly the fair weather, affordable rents, and fast-growing area economy all play a part. The availability of large sums of cash from both legal and illegal sources, and easy access to off-shore banking may also be factors.

One reason so many boiler rooms center their activities in Florida is the presence of what precious-metals dealers call "YAKS" - the salesmen who pitch to prospective customers, whom insiders call "mooches" or "laydowns." South Florida abounds with trained and efficient salesmen, many of whom learned their trade during Florida's land boom in the late '60's and early '70's.

Another reason is sometimes mentioned for the proliferation of fraudulent boiler rooms in Florida: a sense that law enforcement in South Florida is overtaxed and preoccupied with handling the problems of drugs and violent crime. I would like to dwell on this point for a moment.

South Florida is faced with a crime problem that is, I believe, truly unique. Elements of this problem can be found in the crime profile of other large metropolitan areas inside and outside the United States, but collectively the elements in South Florida add up to a crime problem perhaps unique in all the world.

Upon becoming United States Attorney for the Southern District of Florida about 2 years ago, I pointed out that far and away the most serious federal crime problem in this district was the drug problem. Over the last ten years or so Miami had become the point of entry for perhaps 75 percent of all the cocaine and marijuana and methaqualone smuggled into the United States. It was in South Florida that the criminal wholesale transactions of the American drug trade were taking place. Much of that trade continues in South Florida today, and I have committed the resources of my office to confronting and attacking this very serious problem, and the attendant problems of violent crime, the proliferation of firearms violations and corruption.

However, I have also committed the resources of the United States Attorney's Office for the Southern District of Florida to sustained and vigorous prosecution of white collar crime cases. FBI and IRS statistics for FY 1983 show that this office filed at least 141 indictments and 15 informations in white collar and tax cases, producing 129 convictions leading to the recovery of nearly $12 million and fines totaling over $700,000. In addition, the Postal Service made 67 fraud-related arrests. I have more than quadrupled the number of prosecutors dealing with white-collar crime as their full-time assignment.

The results of this commitment and the unique nature of the law enforcement dilemma we face in South Florida can be seen in the numbers.

Criminal case filings in the Southern District of Florida have increased dramatically. For the 12-month period ending June 30, 1982, 842 cases were filed. For the year ending June 30, 1983, there were 1,231 filings, a gain of almost 50 percent and representing more felony charges than were filed in any other federal district in the United States including districts [illegible] substantially greater populations than South Florida, such as New York, Chicago or Los Angeles. Indeed, criminal filings in this district have more than doubled since 1979 when fewer than 600 cases were filed.

The magnitude of the crime problem in South Florida is perhaps best seen in the number of defendants charged in the 1,231 cases filed in the year ending June 30, 1983. Charges were brought against over 2,318 defendants for that period, more than the number charged in the Southern District of New York (Manhattan) and the Northern District of Illinois (Chicago) combined.

And yet, the number of Federal judges in the Southern District of Florida is less than half the number of Federal judges sitting in the Southern District of New York alone.

Let me take a moment to describe to you how a typical boiler room operates. Setting up a boiler room is cheap and simple. All it takes are desks, file cabinets and banks of telephones. Sales personnel work hours on the phones and average $30,000 a year in commissions. Top salesmen may take home $3,000 a week plus bonuses. Fast talk and extremely high sales pressure are the keys to success.

Inside the boiler room, the din can be numbing. Sales people crammed into close quarters yell and cajole over the phone. Music is often blaring. Bells ring when sales are made. An office manager jumps up and down, waving dollar bills and pushing promotional contests. None of this uproar, however, is audible to the customer. Noise is electronically filtered from the phone lines by devices insiders call "confidencers."

Most boiler rooms operate by what is known in law enforcement circles as a Ponzi scheme. Victims are talked into investing through promises of high profits and then strung along through delaying tactics such as the issuance of small dividends or "rebate" payments. Only the most vocal complainants receive any money or metals and new investors are constantly solicited in order to create a pool of money to pay off old debts. Sooner or later the pyramid collapses, the house of cards falls.

The companies begin with prospect lists, sometimes purchased, sometimes derived from ads. Salesmen start with the "front speech," designed to fan curiosity, interest and greed. Prospects who seem "hot" are "papered" - sent a sales brochure often replete with exaggerations and misrepresentations. Next comes a "follow-up" call, usually a week or so after the front call. This is usually the time for the "drive," use of a carefully prepared script crafted to overcome resistance and pressure the sale. With a tough prospect on the line, the room manager will sometimes do a "takeover," breaking in on the line and making a stronger pitch. Managers usually monitor calls and over a circuit closed to the customer instruct salesmen on what to say during conversations.

Last comes the "close," designed to get the check in the mail. Salesmen utilize "objection packages" created to meet and overcome virtually any argument. If victims ask to speak to satisfied customers, the salesmen readily provide the names and numbers of "singers" -- persons in collusion with the scheme, who will give glowing accounts of the firm.

Often the best customers are repeat sales. Salesmen regularly call back prospects with new and special offers. This is known as "loading."

When a boiler room nears its breaking point, the sales people make "drop" calls, offering discounts and premiums such as free trips. Then comes the "bust out." The owners leave town or perhaps just move down the block, open under a new name and start up the scam all over again.

Perhaps this pattern is the most insidious aspect of boiler room fraud -- the ease and facility with which owners and sales people intermingle and move on to other boiler rooms. After a "bust-out," or after law enforcement action such as civil cease-and-desist orders or even criminal indictment, boiler room operators go right back into business, at other boiler rooms or under another company name.

Some major prosecutions now pending in the courts in Miami may be of interest to you.

One major prosecution in this district was the indictment on August 16, 1983, of William and James Alderdice, the owners and operators of the International Gold Bullion Exchange, on charges of conspiracy, mail fraud and wire fraud.

According to the indictment, between November 1979 and April 1983, William L. Alderdice acted as President and Treasurer of IGBE and James D. Alderdice served as Vice-President and Secretary of the company. During this time, IGBE was engaged in the business of soliciting orders from customers throughout the United States for the purchase and delivery of gold, silver and other precious metals. By April 1983, the indictment charged, IGBE had amassed more than one hundred forty million dollars ($140,000,000) from customers seeking to purchase precious metals. However, the indictment charged that throughout this period William and James Alderdice were engaged in a scheme to defraud the public through false representations and promises in order to induce customers to do business with IGBE and to maintain the flow of cash into the corporation.

William and James Alderdice allegedly intermingled corporate funds; neglected to purchase metals at or near the time of receiving money from customers; failed to ship metals in a timely fashion; engaged in stalling and delaying tactics; failed to maintain adequate vault inventories; failed to protect customers' holdings by hedging in the futures market; misrepresented that IGBE was actively mining its own precious metals; shipped out metals sent in by customers for storage and safekeeping; and, in general, diverted, secreted, and dissipated the assets of IGBE through a pattern of extravagant expenditures and reckless mismanagement contrary to representations made to and the appearance presented to customers, and in callous disregard for the security of customers' purchases.

On April 21, 1983, IGBE closed down its operation. Victims of the alleged fraud came from throughout the country, including individuals from Alabama, California, Florida, Georgia, Illinois, Kentucky, Maryland, New Jersey, New York, Ohio, Rhode Island, Texas and Washington. IGBE is presently involved in federal bankruptcy proceedings.

This case has not yet come to trial and is scheduled to commence on May 21, 1984. The defendants, of course, are presumed innocent in the eyes of the law until the Government proves their guilt beyond a reasonable doubt. If convicted, the Alderdices face a total maximum sentence of ninety years in prison and a $27,000 fine each. The Alderdices remain in jail awaiting trial at this time.

Another case worthy of brief note and also involving a precious-metals scheme was a recent indictment against five men for their activities arising out of a Fort Lauderdale company which supposedly sold investments in strategic metals. According to the indictment, the defendants engaged in telephone solicitations of persons throughout the country to persuade them to invest in strategic metals such as tantalum and titanium, whose value they claimed would increase because of their scarcity and use for military and defense purposes. They allegedly promised to store the metals purchased by their customers at warehouses in Southern Florida.

However, according to the charges, the defendants did not acquire metals to cover the sales which they made to their customers. After receiving investments, usually by wire transfer, they would issue warehouse invoices to lull customers into believing their metals had been purchased. In September, 1981, after receiving over $52,000 from ten customers, the defendants closed down the operation. According to the indictment, none of the customers ever received any metals or a refund or were contacted again after receiving the lulling mailings. If convicted, these defendants face penalties of up to 55 years in prison and $19,000 fine, for crimes including mail and wire fraud. The case is presently awaiting trial.

Still another indictment worth noting was the indictment in September 1983 of the officers and salesmen of three inter-related South Florida firms that sold investments in Federal Oil Lease programs: U.S. Oil & Gas Company, Eagle Oil and Gas and the Stratford Company. Victims' losses in this case are alleged to exceed $56 million. Also indicted in connection with this case was Henry Scott Harris, the President of the Better Business Bureau of South Florida, who, according to the indictment, took money to eliminate or alter unfavorable information in BBB reports regarding these companies.

The indictment in that case alleged a scenario typical of boiler rooms, beginning with the telephone call to the prospective client, followed by the mailing of the brochure, the "drive" call for the purpose of closing the sale, and, if the "drive" call succeeded, a "load" call to sell as many additional contracts as possible. The misrepresentations made, according to the indictment, included misstatements as to the IRS position regarding deductibility of the investment; claims that "every penny of your money will be returned to you in full ... You can't lose"; and false accounts of "special" parcels not generally available. The sales pitches appealed to the emotions of the buyers, with language like, "You won't be able to sleep when they hand you that check for close to a million", and pre-scripted responses to any conceivable customer objection were utilized. Pre-printed objection sheets contained prescribed answers for such problems as the "attorney objection", the "Certified Public Accountant objection", and the "wife objection" (with variations depending on whether the wife is present).

This case is pending trial in the fall of 1984, and again, the defendants are presumed innocent until the Government proves their guilt beyond a reasonable doubt.

How significant is the problem of financial loss in precious metals? Let me point you to figures filed in Miami in United States Bankruptcy Court regarding failed metals firms. On November 10, 1982, Universal Precious Metals of Fort Lauderdale closed, leaving behind some 580 creditor claims totalling $7.6 million in losses. On January 14, 1983, JVF Investment of Boca Raton shut down, subsequently producing 100 creditor claims totaling $1.5 million in losses. On April 21, 1983, the International Gold Bullion Exchange closed its doors. Creditor claims now exceed 23,000 with losses estimated at beyond $70 million. On October 20, 1983, United Precious Metals of Boca Raton went out of business, leaving behind some 3,000 creditor claims totaling $1.1 million in losses.

What is law enforcement doing about the problem? In the Southern District of Florida, we have made the vigorous and sustained investigation and prosecution of fraudulent boiler rooms one of our top priorities. To that end we have formed combined investigative and prosecutive forces in this district and we are working in close conjunction with the Federal Bureau of Investigation, the United States Postal Service, the Federal Trade Commission, the Commodity Futures Trading Commission, and various state and local agencies, including the State of Florida's Comptroller's Office and the State Attorney General to identify, monitor and pursue fraudulent boiler room operators in a coordinated manner.

We have had particular success in coordinating Federal criminal action with State cease-and-desist orders. We have also had favorable results executing search warrants against offending companies. On March 6, 1984, Federal agents conducted coordinated raids on nine separate operational sites in South Florida of more than a dozen suspected boiler rooms as part of a coordinated Justice Department crackdown on fraudulent boiler room operations involving at least twenty-two companies in five states. Most of these suspected boiler room companies were involved with oil and gas leases.

Can law enforcement do more in this are? Of course. Only after we have succeeded in repeatedly indicting boiler room salesmen and owners, bringing these people into court, closing down their businesses, recovering the proceeds of the illegal activity, securing convictions, and convincing the judges to impose substantial jail sentences will we have a real impact in discouraging and deterring this fraud.

Certain legislative initiatives could help in this area. At the Department of Justice, the Economic Crime Council has received recommendations from its Operations Committee boiler room subcommittee, and these recommendations are expected to be submitted for legislative review. Both the RICO statute and the Commodity Futures Trading Commission Act of 1974 appear to be areas where enforcement and other provisions could be strengthened, giving more teeth to law efnorcement's control of abusive boiler room operations.

In the meanwhile, one solution to the problem of boiler room fraud, particularly metals fraud, is increased public awareness. Florida has numerous legitimate metals traders, for instance. Companies selling gold and silver over the counter for 2 per cent to 4 per cent commissions are for the most part legitimate businesses. Customers, however, should beware of businesses that promise easy and sure profits in the unpredictable commodities markets, especially through telephone solicitations. Purchasers should be particularly leery of dealers who seek to defer delivery of metal until a later date or who sell leverage contracts offering minimum down payments. Purchasers should resist the high pressure salesman who seeks the immediate payment of substantial sums of money or a "golden opportunity" would be lost.

Until the public learns to better recognize the thievery being worked upon them, the United States Attorney's Office for the Southern District of Florida will continue to go after fraudulent boiler room operators wherever and whenever we can find them, until the message is clearly communicated that South Florida -- for all its warm and sunny weather -- will be a cold, dark, ugly place for con men as well as other criminals.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
ENFORCEMENT

PREPARED STATEMENT OF JOHN M. FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT OF THE SECURITIES AND EXCHANGE COMMISSION

March 21, 1984

Chairman Rudman and Members of the Subcommittee:

I appreciate the opportunity to participate in these hearings on the regulation of precious metals dealers.

INTRODUCTION AND SUMMARY

I begin with six facts. First, some of the marketing of precious metals is conducted through classic boiler rooms and a bouillabaisse of falsehoods to investors. Indeed, a segment of this industry is plagued with lying to, cheating and stealing from investors. Second, I wish I could report that the Commission is busy investigating the malefactors, but during its 50 year history it has had a minimal prosecution presence in this area. Third, the sale of precious metals infrequently involves the sale of a "security" or "investment contract." Consequently, the Commission has no jurisdiction to police much of this fraud. Fourth, even though there is fraud against investors in the precious metals area, there should be no false hope that the Commission has jurisdiction to protect investors from most of the criminals at work here. Fifth, the Commission will initiate enforcement actions when metals dealers operate in a fashion that results in a securities transaction. Finally, the Commission will assist other federal and state law enforcement agencies as they investigate illegal conduct in the precious metals industry.

The failure of several precious metals dealers in 1983 resulted in losses to customers in excess of $100 million. The losses, and the underlying problems in the metals markets, have caused great concern in the financial and regulatory communities. The Commission recognizes the serious threat to investors and shares the Subcommittee's concern regarding unscrupulous dealers that may be defrauding the public of millions of dollars annually. They must be prosecuted and sanctioned.

The volatile and shifting precious metals markets require tough regulation by a combination of state and federal agencies. The malodorous salad of boiler room frauds is best addressed by criminal authorities, and it is there that resources should be concentrated. The Commission may play a role by providing criminal authorities with information regarding dishonest precious metals dealers. We also can make our expertise available to decipher the complex financial transactions in which such dealers engage. The Commission will bring enforcement actions when a metals dealer illegally operates in a fashion that results in a securities transaction.

Though the Commission can bring enforcement actions in appropriate cases, restrictions on its jurisdiction would, in most instances, preclude its action. The Commission, as a general rule, does not have jurisdiction over precious metals dealers. Though dealers may in some instances sell the metals as part of a package that constitutes a "security" -- most typically an "investment contract" -- the Commission generally has no authority to regulate precious metals dealers, and can determine whether it has jurisdiction over a particular dealer only after a careful examination of that dealer's marketing plan. Consequently, there is no basis for systematic Commission regulation of metals dealers, as there is for issuing companies, broker-dealers, investment companies, investment advisers and others in the securities industry.

The Commission does, of course, examine those dealers that appear to be selling securities where those sales may be in violation of the federal securities laws. The operations of two precious metals dealers that collapsed in 1983, International Gold Bullion Exchange and Bullion Reserve of North America, were reviewed by the Commission's Miami Branch Office and Los Angeles Regional Office, respectively. In the IGBE case, the Miami Branch Office determined after consultation with me not to investigate further at the time, due to the considerable law enforcement interest by both federal and state agencies, and the question of whether the Commission had jurisdiction. The Los Angeles Regional Office is monitoring the bankruptcy proceedings in the Bullion Reserve matter.

The limits of the Commission's jurisdiction prevent it from overseeing precious metals dealers in a comprehensive manner. As a result, the Commission does not have extensive information as to the present structure of the metals markets, or the methods of operation of many of the dealers. It would create a drain on resources for the Commission to institute a program to monitor these dealers, most of which clearly are outside this agency's jurisdiction.

The Commission will continue to carry out its mandate under the federal securities laws to protect investors purchasing and trading in securities. In addition, the Commission will give the Congress assistance in its attempts to deal with threats to investors.

TRADING PRACTICES OF PRECIOUS METALS DEALERS

There are a variety of marketing practices employed by dealers to sell precious metals. Some are merely sales tactics, while others constitute an important part of the investment package.

Many metals dealers offer the basic commodity for immediate cash delivery. They represent that precious metals are a good investment and a hedge against inflation. Others frequently provide a number of management services in connection with the sales, including storage and insurance for the purchased metals. In some instances, the purchasers never take possession of the metals, and receive only a certificate representing an interest in metals stored in a vault controlled by the promoter or a third person.

As an inducement to investors, the dealers may represent that they are experts in precious metals trading and that they have years of experience and immediate sources of information from world markets. The dealers may further represent that they will render investment advice to purchasers, such as when to buy and sell metals so as to maximize profits. They may agree to buy back the metals at any time at the prevailing market price (i.e., the spot price), or may offer financing arrangements for the transactions. Financing may take the form of arranging for bank loans for purchases or selling the metals on margin. The dealers may provide an added incentive to customers in the form of a discount for delayed-delivery purchases, with the discount funded by an investment pool of customer money, or may offer a rebate or interest payments so long as the purchaser does not demand delivery of the metals purchased.

SALES OF COMMODITIES OR INTERESTS IN COMMODITIES ARE NOT, WITHOUT MORE, SECURITIES TRANSACTIONS

The mere sale and delivery of a precious metal is not the sale of a "security" for purposes of the federal securities laws. The sale of an "interest" in a precious metal also is not a securities transaction. Congress in 1934 expressed an intent that an interest in property, without more, does not constitute a security. 1/ Consequently, unless a metals transaction involves an "investment contract" or some other specified security the Commission has no jurisdiction over the transaction.

THE INVESTMENT CONTRACT TEST

The "investment contract" test was set out by the Supreme Court in the Howey 2/ case. In Howey, the Court defined an "investment contract" as an investment of money in a common enterprise with the profits from the investment to be derived solely from the efforts of others.

There are many types of transactions that are ostensibly sales of property but that, due to additional services performed by the seller, actually constitute investment contracts. For example, when tied to personal services, there may be a sale of a "security" in the sale of interests in orchards, whiskey warehouse receipts or rare coins. The Commission is alert to the unique and evolving schemes that may involve the sale of a security.

APPLICABILITY OF THE INVESTMENT CONTRACT TEST TO TRADING IN PRECIOUS METALS

Many precious metals transactions are mere commodity sales, and thus not within the Commission's jurisdiction. The dealers may, in conjunction with the sales, render certain limited services without transforming the sales into securities.

Other metals transactions, however, may constitute the offer and sale of investment contracts. The case law suggests that the sale of metals as part of a package together with particular services provided by the dealer may constitute a "security." The determination whether a dealer is selling an investment contract is fact-intensive. There is little case law directly on point, so in some cases there would be no certainty whether there was a security without a judicial ruling on the matter.

MARKETING FACTORS NOT INDICATING AN INVESTMENT CONTRACT

To constitute an "investment contract," the efforts of the promoter or other person must be essential to the anticipated production of profits. There would be no investment contract if these persons performed merely ministerial functions unrelated to the production of profits. Thus, in the case of sales of precious metals, there probably would be no investment contract where the seller agreed merely to store or insure the metals for the purchaser.

Similarly, an offer by a dealer to repurchase the metal at the "spot price" would not transform a commodity sale into a securities transaction. There is a national, liquid market for precious metals. A provision for repurchase at the spot price, without more, would not materially alter the investment, and would not constitute the sort of services that would transform the transaction into the sale of a "security."

1/ H.R. Rep. No. 1838, 73d Cong., 2d Sess. at 39 (1934).

2/ SEC v. W.J. Howey Co., 328 U.S. 293 (1946). The Howey test was restated in United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1974) in which the Supreme Court stated that an investment contract is "an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."

Some buy-back plans might, however, indicate securities transactions. Buy-back plans which involved more sharing of risk between the dealer and purchaser might indicate a transaction constituting an "investment contract." For example, a transaction in which the dealer agreed to repurchase at a set price, or at a fixed percent of the original purchase price, or where the commodity was extremely illiquid due to a limited market, would be more indicative of a securities transaction.

The arranging of financing for precious metals transactions would not, in most situations, transform the sales into sales of securities. Actual sales of commodities financed by a bank or the seller would, absent other factors, have little to distinguish them from financed sales of houses or automobiles. Such transactions are financed purchase transactions and not securities.

MARKETING FACTORS POSSIBLY INDICATING AN INVESTMENT CONTRACT

There may be sales of investment contracts in those cases in which, in conjunction with other services, the dealer offers investment advice in connection with a precious metals transaction. Investment advice might include directions as to (i) when to purchase and sell, (ii) which specific metals are the best investment at a particular time, or (iii) the relative merits of investing in metals as opposed to the stock market. Such investment advice could be an essential managerial effort and an important element of any expected profit.

In addition to investment contracts arising due to the dealer offering investment advice as part of an investment package, there also may be an "investment contract" where the metals dealer returns "profits" to the customer in the form of a delayed-delivery discount, where the discount is funded by an investment pool of investor funds.

Though investment packages including detailed investment advice or a delayed-delivery discount funded by an investment pool may constitute securities, this determination could be made only after a review of the total investment package and the manner in which it was marketed. Further, there is no case law that is directly on point.

INVESTMENT ADVICE BY THE SELLER

In a precious metals transaction where the dealer represents itself as an expert in metals trading and offers to provide the purchaser with expert investment advice, such as when to buy and sell, the offer of advice arguably is material to the expected profit to be earned by the purchaser. This advice, together with other elements, may constitute sufficient managerial efforts to transform the commodity sale into a securities transaction. This investment advice would not be as signficant as advice regarding certain other commodities, since precious metals are fungible, and there are both a ready market for resale and many sources of information regarding the value of the metals. However, the offering of substantial investment advice regarding the metals would present a basis for an argument that the dealer was in fact offering an "investment contract" when the advice was coupled with other services that increased the customers' reliance on the dealer. The full realization of profits from the investment package would be dependent upon the dealer's investment advice. Although the customer could watch the market and sell at an appropriate point, he arguably would receive higher profits by purchasing and selling where instructed by the dealer. As a practical matter, many customers rely on the dealer's advice. Additional advice by the dealer, such as which metal to buy and the relative advantage of investing in metals rather than the stock market, would make the transaction even more similar to a "security." These factors, in conjunction with other elements, such as the provision of storage and insurance by the dealer and a buy-back agreement, may indicate a transaction in which the customer is substantially reliant on the dealer, thereby resulting in an "investment contract."

DELAYED-DELIVERY DISCOUNTS

Some metals dealers offer discounts to purchasers who agree to a delayed delivery. The dealers may discount all or part of their commission depending on how long the customers permit the dealers to delay the delivery. In some cases, the dealers then take the purchasers' money, pool it, and invest it in high-return certificates of deposit or more speculative investments. Though the dealers have immediate use of the customers' money, they are not required to cover the transactions until shortly before the delayed-delivery date. The avoidance of high dealer commissions by means of this arrangement may return a significant "profit" to the purchaser.

Delayed-delivery packages resemble an "investment contract" in the form of an investment pool. The dealers take customers' money, pool it, invest it, and return a "profit" in the form of a substantial discount. Such investment packages may constitute securities in the form of investment contracts.

REBATES OR INTEREST ON PRECIOUS METALS INVESTMENTS

In some instances precious metals dealers may pay customers a stated amount monthly as a "rebate," or as interest for so long as the customer does not demand delivery of the metals purchased. The customer is issued a receipt or statement of ownership for the metals that were owed by the dealer. Such a receipt or statement arguably constitutes an "evidence of indebtedness" within the meaning of the federal securities laws. The mass solicitation of funds by the dealer offering a fixed rate of return on investments would indicate an investment, rather than a commercial transaction.

CONCLUSION

While the Commission arguably has jurisdiction to regulate some precious metals transactions, the absence of a "security" in most of the transactions would prevent the Commission from overseeing the sales in a comprehensive manner. Moreover, the methodical regulation of bare commodity sales is outside the traditional jurisdiction of the Commission. The securities laws were drafted to regulate investment and trading in the securities of investment enterprises, and not commodity cash sales transactions. Any exercise of jurisdiction by the Commission over such commodity sale transactions would constitute a change in its historic role as overseer of the issuance and trading of securities.

The Commission recognizes that concerted action is required by state and federal agencies to resolve the illegalities in the precious metals markets. We will continue to investigate metals dealers where appropriate, and will refer matters to other federal and state agencies where the Commission determines that it does not have jurisdiction, or that action by another agency may be more appropriate in a particular situation. We would be happy to consider participation in any inter-agency task force proposed by Chairman Rudman and assist other agencies by means of our expertise in securities matters.

PREPARED STATEMENT OF DENNIS KLEJNA, DIRECTOR
DIVISION OF ENFORCEMENT
COMMODITY FUTURES TRADING COMMISSION

Mr. Chairman, Members of the Subcommittee, I am Dennis Klejna, the Director of the Division of Enforcement of the Commodity Futures Trading Commission. The Commission is the federal agency charged with the regulation of commodity futures markets. I appreciate the opportunity to appear before the Subcommittee to provide whatever information and insight I can regarding precious metal boiler room activity in the United States.

Boiler room activity or the use of high pressure sales pitches over the telephone has been a favorite tool of unscrupulous characters for many years. Sales of land, vacation packages, oil leases, strategic metals, and the like have all been in vogue at one time or another. Investment in precious metals arises from the desire of people to provide for their future security. For centuries, precious metals have been perceived as a safe investment, a haven, particularly in unsettled times.

The success of boiler room operators pitching coal, precious metals, and "strategic" metals to the unwary has at least two undesireable facets -- first the theft of savings and the future dreams of innocent citizens and, second, the draining off of money which otherwise could be funneled into legitimate investments.

The CFTC's primary mission is to regulate the eleven commodity futures exchanges and the nearly 70,000 futures professionals who deal with the public. In addition, the Commission has jurisdiction over leverage contracts and dealer options. As a regulator the Commission strives to assure that the conduct of regulated commodity professionals conforms to statutory requirements. In contrast, those who engage in off-exchange fraudulent activity scorn regulation and choose, rather, to operate outside the legal framework.

Since the approach of some of these boiler-rooms is to tout gold, silver and other products which also are traded on the futures markets, the Commission has a strong interest in working to find ways of combatting this fraudulent activity.

As the activities of the scam artists and boiler-room operators who prey on the theme of precious metals investments are not susceptible to traditional business regulation, other methods of dealing with these people must be employed.

I believe that great progress has been made in this regard during the past two years.

When the CFTC appeared before this Subcommittee approximately two years ago, during your scrutiny of the sale of off-exchange commodity instruments, a key focus of your concern was the inability of state law enforcement officials to utilize the provisions of state law in attacking off-exchange boiler room activities. We believe meaningful opportunities for increased state involvement in this area were contained in the Futures Trading Act of 1982. In the 1982 Act, Congress enacted a new Section 12(e) to the Commodity Exchange Act which eliminated any restriction on criminal prosecution of commodity wrongdoing under any federal criminal statute. Perhaps more importantly, this "open season" provision eliminated the preemption of any federal or state statute or rule with respect to commodity transactions that are not futures contracts traded on designated contract markets or that are not subject to regulation by the Commission as authorized options transactions, leverage transactions or dealer options. Section 12(e) also eliminated the preemption of any federal or state statute or rule with respect to any person required to be registered with the CFTC but who fails or refuses to do so. In short, any statute or rule of any of the fifty states or any other federal statute or rule may be utilized in attacking so called off-exchange commodity boiler room activity.

The 1982 Act also included an expansion of Section 8(e) of the Commodity Exchange Act to permit the furnishing of any information in the Commission's possession to any department or agency of any state or local government for law enforcement purposes. In addition, a new Section 8(g) specifically provides for the furnishing of registration information maintained by the Commission upon a reasonable request made by any state.

These changes in the federal statute come at a critical time. From news reports and from our own observation, the past two years have seen some changes in the type and location of investment fraud being perpetrated on the public. For example, during the Subcommittee's last hearings, and as reflected in its final report, the vast majority of the fraudulent schemes examined by your staff were located in Florida and the Northeast, particularly in New York City. The past two years have seen a trend toward fraudulent operators locating particularly in Southern California and Arizona. We also perceive a continued boiler-room problem in Florida, and as reflected most recently in the actions of the State of Florida and the United States Attorney in Miami against boiler-room operators touting oil and gas lease investments, the boiler rooms there are involved in activities beyond commodities.

In his statement to the Subcommittee two years ago, Richard Latham, the Texas State Securities Commissioner said "As to off-exchange transactions the need for uniformity of regulation is overshadowed by the need for an effective criminal justice system." We think it is fair to say that no clearer message came from your work in 1982 than the need for more active state involvement in prosecuting off-exchange activity, more particularly, state criminal prosecutions. It is our view that the most effective method of stopping precious metals fraud is to utilize the state and federal criminal law provisions. As the state of New York recently showed in its criminal prosecution of the Mineral Resources case, the best remedy is jail. Swift and thorough enforcement action sends a simple and understandable message to precious metals boiler room operators -- stop or go to jail. The 1982 amendments to the Act give the states explicit authority to send this message.

We stand committed to assist in this effort. The 1982 amendments have provided a unique opportunity for the Commission and the states to forge a new partnership in the effort to eradicate commodity theme frauds. Through the "open season" provision, this partnership can now include both criminal deterrents and civil and administrative actions by the states against those who fail or refuse to comply with either the Commodity Exchange Act or applicable state laws.

The benefit of the "open season" and the spirit of cooperation which has emerged between the Commission and the states is that the full weight of the enforcement authorities of the 50 states and the hundreds of local jurisdictions can now be brought to bear on the problem. New state legislation and civil procedures may be devised to inhibit and prohibit such fraudulent activities. These will complement present criminal laws of the states and the Commission's regulatory scheme.

In this connection, representatives of the Commission, including a Commissioner, met in January of this year with representatives of the North American Securities Administrators Association ("NASAA") and the National Futures Association ("NFA") -- the futures industry's self-regulatory body — to establish a working group for the development of model state legislation which would dovetail with the federal regulatory scheme in order to form a comprehensive scheme of laws governing the sale of precious metals. The form this legislation will take will be determined by state needs.

On the regulatory front, the Commission has recently adopted comprehensive rules in the area of leverage contracts based upon federal law and its legislative history. These rules are designed to make clear which type of instruments will be regulated by the CFTC and those which may be subject to the states, free of issues of preemption.

With the Commission setting standards for commodity futures, options, dealer options, and leverage transactions and the states utilizing the Commodity Exchange Act, current state law and model state legislation, and with all of us dedicated to full cooperation and assistance, we hope to continue to make life quite uncomfortable for those boiler-room operators. For its part, the Commission has already laid the groundwork for this effort.

Since the Commission last appeared before this Subcommittee, the Commission has taken several actions to enhance the development of its partnershp with the states. We have conducted two national CFTC-State Cooperative Enforcement Seminars which have been attended by representatives of 30 states and conducted the first CFTC-State Cooperative Enforcement Seminar on a regional basis in Los Angeles. This was attended by 50 representatives of western states. We have granted access to our files to state officials; and we have begun work on producing a "Commodity Law Violators Manual" for distribution to state and federal authorities. We have filed 12 cooperative enforcement actions in federal court with five states under Section 6d of the Act. We worked with officials of the state of Arizona in taking advantage of Section 12(e) by filing the first action in state court alleging fraud with a commodity theme.

We have also undertaken to include federal enforcement officials in our cooperative effort. In the last two years we have conducted a four week pilot program for FBI agents; conducted training programs and seminars for the Internal Revenue Service in New York and Chicago and for Assistant United States Attorneys in the Southern District of New York; provided expert witness assistance to federal prosecutors in Chicago, Dallas, New York, Boston, Miami and San Antonio; provided sentencing information; and met with representatives of the Department of Justice Economic Crime Council to help establish the prosecution of commodity related boiler room fraud as a national priority.

This commitment to assist the states and other federal agencies in pursuing off-exchange commodity-related fraud is one of the highest priorities of the Commission and certainly of the Division of Enforcement. The Commission has established a State/Federal Liaison Unit whose major responsibilities are in this type of state/federal cooperation, and we are routinely providing expertise, advice and information to state and other federal officials on commodity related enforcement matters. Commissioners have lent their personal support to this effort by fostering constructive relations with NASAA and individual state authorities, by serving on the Commission's Advisory Committee on CFTC-State Cooperation, and by participating in programs to educate the public on ways of avoiding commodity theme frauds.

Meaningful attention has been focused on the problem of commodity fraud by this Subcommittee, and by the recent actions of the Commission and various state officials in both federal and state court. Moreover, the Department of Justice has indicated a great interest in pursuing these frauds. A high degree of cooperation and communication currently exists among state and federal law enforcement agencies.

Our effort to provide expertise, information and assistance to the state and federal prosecutors and officials closest to the problem is the most effective means of attacking the kind of callous unlawfulness exemplified by the off-exchange boiler-room operator. State officials and state and federal prosecutors will continue to commit their limited resources to the areas of that primary responsibility. The Commission will continue to do all it can to assist state officials and federal prosecutors in attacking off-exchange fraud.

This completes my prepared remarks.

PREPARED STATEMENT OF AMANDA B. PEDERSEN, DEPUTY DIRECTOR
BUREAU OF CONSUMER PROTECTION
FEDERAL TRADE COMMISSION

Mr. Chairman and Members of the Subcommittee: thank you for inviting me here today to discuss what the Federal Trade Commission is doing to combat fraud in the sales of various investments, and particularly, precious metals.[1] I welcome this opportunity to comment on the problem of investment fraud schemes in the United States. In the past several years, an increasing number of firms have bilked individual consumers an average of $5,000-$10,000 each by promising large investment returns with little or no risk. Many of these firms are telephone boiler rooms, using high pressure, polished sales pitches sometimes supplemented by ads in major publications, mail solicitations and slick promotional brochures. These firms sell gold or silver bullion, precious and semi-precious gemstones, oil and gas leases or related services, strategic metals, antiquities, shares in coal mines, oil wells, or any other item that lends itself to a deceptive sales presentation.

Over the past several years, the Commission has committed an increasing amount of its resources to law enforcement in this area. Since 1981, the Commission has brought seven investment fraud cases and obtained preliminary or permanent district court injunctions against 41 defendants. We have already obtained and distributed $125,000 in redress funds to defrauded consumers, and in the near future, we expect to obtain millions of dollars more in consumer redress.[2]

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[1] The views expressed are those of Amanda B. Pedersen, Deputy Director of the Bureau of Consumer Protection. They do not necessarily reflect the views of the Federal Trade Commission or any individual Commissioner.

In discussing the Commission's role in combatting investment fraud, it must be kept in mind that the FTC is a civil enforcement agency, without any authority to initiate strictly criminal proceedings. Thus, the law enforcement tools available to the Commission are civil remedies, such as administrative orders, federal court injunctions, consumer redress, industry-wide guidelines, and trade regulation rules.

I would like to begin with a brief overview of recent efforts by the Commission to combat investment fraud schemes. Fraudulent investment schemes are remarkably similar, regardless of the product being sold. The common element is usually high-pressure sales tactics guaranteeing consumers uncommonly large returns on their investments. Risks or caveats are never disclosed.

The Commission has primarily focused its efforts on those schemes where neither the SEC nor the CFTC appears to have jurisdiction. The Commission's cases thus far have been in two main areas, investment gemstones and oil and gas lease lottery filing services, although recent investigations of precious metals dealers may lead to litigation in the future. I believe that the staff of the FTC's Division of Services Industry Practices is to be commended for its creative and effective actions against these investment schemes.

Since 1982, the Commission has brought three cases challenging alleged consumer fraud in the sale of gemstones as investments. Industry sources estimate that since 1980, sales to the public of gemstones as investments have exceeded $750 million. The Commission believes that many of these sales were the result of fraudulent sales presentations that misrepresented, among other things, the liquidity and appreciation rates of gemstones. One of the Commission's pending gemstone cases is against International Diamond Corporation, formerly the nation's largest retailer of investment diamonds. The Commission's evidence in this matter indicates that investors may have lost in excess of $100 million as a result of the firm's practices. While the FTC's litigation cannot produce complete consumer redress, the staff expects to obtain millions of dollars for consumers through ongoing settlement negotiations.

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[2] See Appendix A for a brief description of the cases in the investment fraud area that the Commission has brought since 1981.

Since December 1982, the Commission has also brought four separate federal district court proceedings to challenge suspected fraud in the sale of what are represented to be investment services related to the Department of Interior Bureau of Land Management's lottery of oil and gas leases on federal lands. The staff estimates that the sales practices of the telephone boiler rooms in these four proceedings imposed losses on investors exceeding $70 million. As a result of Commission action, the 30 corporate and individual defendants named in those matters are now under court orders prohibiting them from making various misrepresentations, including misrepresentations about the likelihood and value of obtaining oil and gas leases in the BLM's lottery. Moreover, in the Commission's case against U.S. Oil and Gas, the staff obtained temporary freeze orders preserving assets worth about $12 million for possible redress to consumers. The staff also successfully sought the appointment of a temporary receiver to assume control of the operation of the corporate defendants. Although the fraudulent practices have already been enjoined, the staff continues to litigate three of these cases to finalize effective relief and to obtain consumer redress. At the same time, the staff is pursuing investigations of similar fraudulent schemes. Two more related law enforcement actions may be filed in the very near future.

In the course of its investment fraud efforts, the Commission staff in Washington in 1981-1982 and in its Chicago Regional Office in 1983 also investigated a number of precious metal dealers, including International Gold Bullion Exchange, Bullion Reserve of North America, and United Precious Metals. For a variety of reasons, no law enforcement actions resulted from these investigations.

More recently, however, the Commission's headquarters staff has identified several other precious metals dealers suspected of engaging in high pressure, boiler room sales tactics. Through contacts with law enforcement officials in Florida, California, Texas, Arizona, and other states, the staff is acquiring further information on these companies and developing additional leads. This investigation is continuing.

With regard to the Commission's earlier investigations, the Commission resources were devoted primarily to examining IGBE. As described in some detail hereafter, two separate offices investigated the company at different times, with substantial consultation with other federal, state, and local authorities. While initially there was no basis for FTC involvement, IGBE's changing practices later led to other evidence tending to support an FTC action. However, other law enforcement agencies took action rendering moot any role for the FTC.

The FTC staff began to monitor the activities of International Gold Bullion Exchange or "IGBE" in April 1981. Between April 1981 and July 1982, the staff collected information on IGBE from IGBE President Mr. William Alderdice and various federal, state, and local organizations. This information consistently showed that virtually all complaints about IGBE were eventually resolved to the consumer's satisfaction. Indeed, agents of the Postal Inspector's Office and the Federal Bureau of Investigation informed Commission staff in April 1981 and May 1982, respectively, that they intended to close their investigations of IGBE because IGBE customers eventually received full refunds or the precious metals they ordered. Based on this information, none of these initial staff inquiries into the operation of IGBE went beyond the preliminary stage. Instead, resources were devoted to investigations of other investment frauds causing substantial consumer loss.

In about November 1982, the Commission's Headquarters staff and Chicago Regional Office began receiving information indicating that consumer complaints against IGBE were not being satisfied, even after prolonged periods of time. In January 1983, the FTC's Chicago Regional Office opened a preliminary investigation of IGBE, and began to develop a file on IGBE. Staff files in Washington were forwarded to Chicago and the Chicago Regional Office began contacting federal and state law enforcement officials regarding IGBE's operation. By March 1983, the Chicago Regional Office had compiled a list of approximately two hundred complainants who had been unable for substantial periods of time to obtain refunds or the precious metals they had ordered.

During March and April 1983, the staff in the Chicago Regional Office discussed taking possible law enforcement initiatives against IGBE with various federal and state law enforcement officials, including the CFTC, SEC, FBI, and the Offices of the U.S. Attorney in Chicago, Miami, and Washington, D.C. As a result of these discussions and the information obtained on IGBE's operations, the Commission's Chicago Regional Office requested the Bureau of Consumer Protection's clearance to proceed with a full-phase investigation of IGBE on April 21, 1983. The staff immediately began compiling consumer affidavits and drafting internal memoranda in preparation for possible litigation with IGBE to stop its deceptive sales practices and to obtain consumer redress.

During the Chicago Regional Office's preparations, officials from the states of Illinois and Florida obtained cease and desist orders against IGBE requiring IGBE to cease its violations of the states' securities and consumer protection laws. On April 21 and 22, 1983, the states filed actions freezing IGBE's assets. Five days later, on April 27, 1983, IGBE ceased operations and petitioned for Chapter 11 Reorganization under the U.S. Bankruptcy Laws. On May 4, 1983, the FTC was informed by a representative of the Miami U.S. Attorney's office that criminal proceedings would be initiated in the near future. As a result of the freeze of IGBE's assets by state authorities, the bankruptcy petition, and the expectation of criminal proceedings, the Chicago Office began reconsidering the need for Commission action against IGBE. Its request for authority to proceed with a full-phase investigation was temporarily put "on hold" to assess the developments in other law enforcement actions.

In August 1983, the bankruptcy trustee converted IGBE's bankruptcy proceeding to a Chapter 7 liquidation proceeding due to the unlikely prospects of reorganization. After state and federal authorities obtained criminal indictments against the principals of IGBE in July and August of 1983, the Chicago Regional Office closed its investigation of IGBE. FTC action was no longer necessary to prevent future deceptive sales practices in light of the termination of IGBE's operations. Moreover, it was no longer practical for the Commission to pursue an action for consumer redress because of the number of creditors in the bankruptcy proceeding and the negligible amount of IGBE assets remaining.

With regard to other precious metals dealers, in May 1983, the Chicago Regional Office opened a preliminary investigation of various other sellers of gold and silver bullion. The Chicago staff identified several companies, including Bullion Reserve of North America and United Precious Metals, that were possibly engaged in fraudulent activity. In the following months, staff contacted sales agents of these firms, obtained the firms' promotional brochures, and requested referrals of complaints and information about these firms from state securities and consumer protection authorities. By October 1983, the Chicago Regional Office learned that Bullion Reserve of North America, United Precious Metals, and several other firms were no longer in operation. In addition, the Chicago Regional Office was informed by the CFTC that four other firms identified by the staff were subject to CFTC regulations because of their practice of selling precious metals on leverage contracts. With regard to the remaining firms identified by the staff, the Chicago Regional Office did not find sufficient evidence of deceptive sales practices to proceed. As a result, none of the Chicago Regional Office's investigations of the firms it initially identified went beyond the preliminary stage.

The Commission's investigations of precious metals dealers were part of an active program to combat investment fraud. Since 1981 the Commission has expanded its program and increased its commitment of resources. In fiscal year 1981, Commission attorneys, research analysts, and investigators spent over 8,000 hours on investment fraud investigations. That number increased to over 8,500 hours in fiscal year 1982, and nearly tripled to almost 24,000 hours in fiscal year 1983. In the current fiscal year, Commission professionals have already expended over 10,000 hours in the investigation and litigation of fraudulent investment schemes to date.

I expect this resource commitment to continue and that the FTC will remain an effective force in the battle against investment fraud. Since becoming Chairman in 1981, Chairman Miller has repeatedly voiced his support for FTC actions to attack fraud and deception in the marketplace.

Investment scams continue to proliferate, however, even as the Commission has increased its commitment of resources. Based on information acquired from the cases the FTC has brought to date, fraudulent investment schemes appear to be located throughout the country but principally in Southern California and Southern Florida. The number of such schemes and the amount of money invested in them cannot be precisely determined. Most of these operations refuse to divulge financial information to private reporting services, such as Dun & Bradstreet. Thus, precise aggregate sales figures are not readily available.

We can only estimate the extent of injury these firms impose on small investors. For example, International Diamond Corporation had annual sales in excess of $100,000,000 in the three years preceding the filing of the Commission's lawsuit. U.S. Oil and Gas Corporation and its related companies had sales in excess of $40,000,000 over a two-year period prior to the Commission's proceeding against them. Extrapolating from these figures and similar figures acquired through other Commission investigations, we believe that more than 500 such operations may exist with total annual sales of between $200 and $400 million.[3]

The Commission faces some difficulties in bringing actions against such investment fraud schemes, and in particular fraudulent precious metals dealers. The primary difficulty stems from the Commission's status as a civil law enforcement agency. Our processes for obtaining information from a company are cloaked with substantial procedural safeguards, which may impede the staff from obtaining information quickly from an uncooperative company. This is a marked contrast to the streamlined procedures available to those agencies authorized to obtain criminal search warrants.

To bring actions against precious metals fraud dealers, the Commission often needs to obtain information about the internal operations of the firms. This information is often valuable, even critical, to the staff's and the Commission's determination of whether the firm has sufficient resources to enable it to deliver the precious metals ordered for future delivery. Such information may also be useful to determine the extent of consumer injury and the source, location and amount of a firm's assets.

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[3] These estimates include companies that offered oil and gas lease filing services in connection with the BLM oil and gas lease lottery at the time the lottery was suspended in September 1983, because of the erroneous inclusion of parcels of land known to have oil and gas reserves. The Commission staff believes many of these companies have temporarily switched into selling other investment schemes and may resume selling lottery filing services once the BLM resumes the lottery.

The Commission's primary investigative tool to obtain information about the internal operations of a precious metals fraud suspect is the Civil Investigative Demand or "CID". Enforcement of a CID against a non-cooperative recipient, however, can be a cumbersome and extremely lengthy process. Through various procedural maneuvers, firms can avoid responding to a CID for periods ranging up to eighteen months and more. Where fraud is suspected, non-cooperation is expected. The available delay in the CID enforcement process permits suspects to dissipate or remove corporate assets, and renders the CID an inappropriate investigative tool in most investment fraud schemes. The exception to this is CID's to cooperative third parties, which have been effective.

Not surprisingly, therefore, the Commission actions in the investment fraud area have been cases where our staff was able to develop the necessary evidence to proceed through independent sources. Even in these cases, however, the Commission's difficulty in securing internal financial data during the investigative stage has made obtaining consumer redress more difficult, and in some cases, it may reduce the amount of redress we ultimately secure for defrauded consumers.

The Commission's primary independent source of information is often another law enforcement agency. The Commission views the exchange of information with federal and state authorities as essential to its role as an effective law enforcement agency. The Commission works on almost a daily basis with state and other federal agencies in the investigation and prosecution of investment fraud. For example, in the IGBE case, Commission staff was in frequent contact with State Attorney General Offices, Postal Inspectors, and representatives of the CFTC, FBI, U.S. Attorney's offices, and the SEC to exchange information about possible federal law enforcement efforts. In the IDC case, we have had extensive contacts with the U.S. Attorney for the Northern District of California and assisted the state of Missouri in its criminal action against IDC by generating and providing extensive computer analyses of data of IDC's sales within that state.

In the oil and gas fraud area, our staff has had frequent contact with the Office of the Postal Inspector, the SEC, and the Office of the Comptroller in Florida. We have obtained consumer complaint referrals from many of these same agencies. Shortly after we filed our actions against four oil and gas lease filing services, the Comptroller's Office issued cease and desist orders against 32 similar boiler rooms located in Florida. We are also participating in a recently created task force comprised of representatives of the Department of Justice, Office of the Postal Inspector, FBI, SEC, BLM, and FTC. In addition, the Commission staff has recently sent a letter to the Alaska State Senate supporting a bill that would subject the sale of Alaska oil and gas leases to the state's securities laws.

The Commission staff has often found inter-agency contacts to be valuable in facilitating the exchange of information and the coordination of federal law enforcement action. If the Subcommittee recommends the formation of an interagency task force on precious metals fraud, the Commission would be pleased to participate.

APPENDIX A

I. Investment Gemstone Cases

A. FTC v. Kimberly International Gem Corporation, (Civ No. 83-5268 MRP (GX), C.D. Cal.)

1. Filed August 15, 1983 in the U.S. District Court for ~~the~~ Central District of California.

2. Defendants:
   Kimberly International Gem Corp.
   International Gemological Society, Inc.
   Steve Angelica
   Stephan Small
   Frank Kimball
   Harvey B. Levitt
   Robert McCallum
   Jean Paul Pierre
   Rene Dupont

3. Status: in litigation. Companies out of business.

4. Relief obtained: Temporary restraining orders and preliminary injunctions against nine individual and corporate defendants prohibiting defendants from misrepresenting the market value, liquidity and appreciation rates of gemstones; asset freeze against Kimberly and two individual defendants; temporary receiver for Kimberly appointed in September of 1982.

5. Estimated annual sales: $4,000,000.

B. FTC v. International Diamond Corporation, (Civ. No. 82-0878, N.D. Cal.)

1. Filed March 4, 1982 in the U.S. District Court for the Northern District of California.

2. Defendants:
   International Diamond Corporation
   Bernhard Dohrmann
   Thomas Lewsader
   Steven Greenbaum
   Susan Greenbaum Alpert

3. Status: in litigation. Company out of business.

4. Relief obtained: Several defendants consented to permanent injunction prohibiting defendants from misrepresenting the market value, liquidity and appreciation rates of gemstones. Case currently being tried for permanent injunction and consumer redress; proposed settlement of case for $6.7 million in redress being finalized.

5. Estimated annual sales: $100,000,000 in 1980; $150,000,000 in 1981.

C. In the Matter of American Diamond Company, (FTC Doc. Nos. C-3095 and C-3096)

1. Administrative Complaint issued July 29, 1982.

2. Defendants:
   American Diamond Company
   Thomas L Baker, Inc.
   Thomas L. Baker

3. Status: completed matter. Company out of business.

4. Relief obtained: Stipulated agreement containing an order to cease and desist from misrepresenting the market value, liquidity and appreciation rates of gemstones.

5. Estimated annual sales: $20,000,000.

II. Oil and Gas Cases.

A. FTC v. First Petroleum Corporation of America, (No. 82-2744 CIV-EPS, S.D. Fla.)

1. Filed: December 21, 1982 in the U.S. District Court for the Southern District of Florida.

2. Defendants: First Petroleum Corporation of America
   Anthony W. Liggio
   Frank E. Blanco
   Sheila Stamm

3. Status: completed matter. Company out of business.

4. Relief obtained: Stipulated final judgment, including redress of $125,000 and a permanent injunction entered April, 1983 against the corporation and three individual defendants prohibiting defendants from misrepresenting the likelihood of winning a lease.

5. Estimated annual sales: $1,600,000.

B. FTC v. J&R Marketing Corporation, (No. 83-1231 CIV-JE, S.D. Fla.)

1. Filed May 18, 1983 in the U.S. District Court for the Southern District of Florida.

2. Defendants: J&R Marketing Corporation
   Ray Belitsky
   James L. Bianco
   Brian Lounsbury
   Joe Ryan
   Steve Marx
   Mark Leslie

3. Status: in litigation.

4. Relief obtained: Stipulated preliminary injunction against the corporation and six individual defendants prohibiting defendants from misrepresenting the likelihood of winning a lease; moved for asset freeze and appointment of receiver.

5. Estimated annual sales: $2,000,000.

C. FTC v. Leland Industries, Inc, (No. 83-3518-CBM (PX), C.D. Cal.)

1. Filed June 3, 1983 in the U.S. District Court for the Central District of California.

2. Defendants: Leland Industries, Inc.
   Leland Capital Corporation (California)
   Leland Capital Corporation (Texas)
   Paul Colacecchi
   Alexander Goodman
   Peter Labarrie
   H. Joel Stanley
   Stephen M. Thompson

3. **Status:** in litigation.

4. **Relief obtained:** Stipulated preliminary injunction against three corporate defendants and four individual defendants prohibiting defendants from misrepresenting the likelihood of winning a lease; stipulated temporary restraining order against one individual defendant.

5. Estimated annual sales: $8,000,000.

D. FTC v. U.S. Oil & Gas Corporation, (No. 83-1702 CIV-WMH, S.D. Fla.)

1. Filed July 7, 1983 in the U.S. District Court for the Southern District of Florida.

2. Defendants: U.S. Oil & Gas Corporation
Eagle Oil & Gas Corporation
The Stratford Company
Gurdon Wolfson
J. Leonard Diamond
Richard S. Wolfson
Martin Rotberg
Harold Cooperman
Irving Sand
Milt Sand
Mark Simpson
Harvey Ganz
Mike Bennett aka Felix Dunbar
William Martin
Sandy Gold
Larry Waxman

3. **Status:** in litigation.

4. **Relief obtained:** Stipulated permanent injunction against one individual defendant and preliminary injunctions against the three corporate defendants and seven individual defendants prohibiting defendants from misrepresenting the likelihood of winning a lease; freeze of the corporate assets worth an estimated $12 million; receiver appointed January 9, 1984.

5. Estimated annual sales: $10-15,000,000.

PREPARED STATEMENT OF JOSEPH H. HARRISON, JR.

VICE PRESIDENT AND GENERAL COUNSEL
NATIONAL FUTURES ASSOCIATION

BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MARCH 21, 1984

National Futures Association

NFA

NFA

Testimony of Joseph H. Harrison, Jr.
Vice President and General Counsel
National Futures Association

Chairman Roth; Vice Chairman Rudman; Distinguished Members of the Permanent Subcommittee on Investigations; Ladies and Gentlemen.

I am Joseph H. Harrison, Jr., Vice President and General Counsel of National Futures Association. With me are Daniel A. Driscoll, NFA Vice President-Compliance, and Douglas L. Campbell, NFA Director of Investigations. We are pleased to come before you today on behalf of the new self-regulatory organization for the futures industry. NFA exists because Congress believed in the premise of self-regulation and the promise of NFA. Aware of this congressional confidence, the futures industry knew it must deliver -- and deliver fast. With the unqualified support of all segments of the futures industry NFA has become -- in less than 18 months -- an important regulatory force in the futures industry.

The futures industry is committed to the fight against boiler room and other unethical sales practices. To wage this battle within its own ranks the industry has provided NFA with effective regulatory weapons.

The linchpin of NFA's comprehensive regulation is uniform required membership. Under the Commodity Exchange Act, CFTC and NFA rules provide that NFA Members may deal with CFTC registrants (other than floor brokers) only if they are also NFA Members. Since futures transactions must ultimately be handled by an NFA Member, these rules are calculated to guarantee the public that all futures investments on the nation's licensed markets will be handled only by persons within NFA jurisdiction.

Among its Members NFA is equipped to prevent wrongdoing or to detect, remedy and punish wrongdoing if it occurs. Members are subject to rules requiring adherence to high standards of commercial honor. Through extensive scheduled and surprise on-site inspections by NFA Compliance staff; through investigations initiated by customer complaints or information supplied by Members or other regulatory agencies such as the CFTC, the states and National Association of Securities Dealers, Inc.; and through review of advertising and solicitation materials, NFA is able to take prompt remedial action whenever there appears to be a danger to futures customers.

NFA has taken a number of these actions. And where there has been a need to call upon the additional power of the courts to issue an injunction, appoint a receiver or freeze assets, the CFTC has mobilized its forces and worked hand in hand with NFA to get that done.

Unfortunately, however, the lure of quick money to be made from the "mooches" -- as crooks often term customers -- continues to draw the unscrupulous into schemes involving leverage look-alike contracts in precious metals or exotic "commodities." Although these schemes usually lurk outside the structure of CFTC regulation and self-regulatory control, the sad reports of the inevitable customer losses cast a shadow over the legitimate futures industry. For this reason NFA does not limit its efforts to detecting wrongdoing among its Members in the futures industry. On the contrary, NFA is committed to doing everything it can to help the appropriate state or federal authorities bring to book those fraudulent operators who damage the futures industry's good name.

NFA firmly believes that the state and local enforcement authorities need only cooperation and encouragement to be positioned on the front line in this battle. In 1982 Congress also recognized that the states were an important force in combating fraud and gave the states, through the "open season" provision, the authority to adopt and apply their own laws to control commodity related investment schemes operating outside the structure of federal regulation. Fraud is, of course, illegal in every state, but the states clearly need special tools in their law to focus and speed enforcement powers. For instance, few, if any, states have laws making it illegal per se under state law to operate without CFTC registration if registration is required. States need the flexibility of such laws to allow swift action in those cases without having to amass complicated proof of actual fraud.

To fill that need NFA and CFTC have pooled their resources and expertise with the North American Securities Administrators Association in a working group to draft a Model State Commodity Code. This cooperative effort will put flesh on the bones of "open season." The Model State Commodity Code will allow the states to stand shoulder to shoulder with the CFTC and NFA in the effort to eliminate regulatory "safe havens" for the unscrupulous.

In the meantime, NFA is working hard to allow existing laws to be brought to bear on non-NFA Members who defraud the public.

NFA early on appointed Douglas L. Campbell as its Enforcement Liaison with the states through the North American Securities Administrators Association. Under Mr. Campbell's direction NFA regularly reviews newspapers and periodicals for suspicious advertising -- especially want ads for telephone sales personnel -- and relays this information to the appropriate state and the CFTC. In addition, through customer complaints and tips from NFA Members (who are often among the first to spot a boiler room), NFA is able to put the right authorities onto a problem. Thus far NFA has made more than 35 referrals to both the CFTC and the states which have resulted in a number of enforcement investigations and actions by the CFTC and by the states including the states of Pennsylvania, Arizona, Florida, Washington and California.

NFA has also joined forces with the states and the CFTC in a number of other areas, specifically:

- Experienced NFA personnel have provided on-site help in analyzing volumes of records to prepare pleadings and proof in enforcement cases,
- NFA has provided expert witness affidavits and factual affidavits to assist in the filing of CFTC and state enforcement actions,
- NFA has participated in CFTC training panels and has scheduled its own training classes for state and local enforcement personnel to help them in understanding commodity related operations,
- NFA has participated with the NASAA Special Projects Committee in the identification and prosecution of boiler rooms selling off-exchange precious metals contracts, and
- NFA is developing a computerized disciplinary history file which will be available to state authorities so they can identify known violators at an early stage.

Finally, NFA understands that the smooth, strong willed boiler room salesman will never be truly defeated unless the public -- his target -- is adequately armed in self-defense. The salesman attacks with questions -- all of which have only yes answers and all of which lead to the final "yes, I'll send the check." He doesn't want to answer questions -- he only asks them. The customer needs to be armed with the questions that will distinguish the illegitimate from the legitimate solicitor. To that end NFA is preparing a leaflet for general distribution entitled "Before You Say Yes - 15 Questions to Turn Off a Swindler." NFA intends to give that leaflet the widest possible circulation. In addition, NFA is participating with the NASAA Public Awareness Committee in an Investor Alert to be published in conjunction with the Council of Better Business Bureaus. NFA hopes by these and other educational efforts to help people protect themselves from being taken in by boiler room operators.

Con artists will be attracted to commodity related scams as long as they see the potential for quick easy profit. Only by constant vigilance can regulators and law enforcement officials effectively deter these people. NFA believes that this effort will be effective only through the cooperative efforts of all regulatory authorities. As a new self-regulator NFA is in a unique position to foster that kind of cooperation. We are proud of what we have been able to accomplish in our short history and look forward to continuing our efforts.

ICTA
INDUSTRY COUNCIL FOR TANGIBLE ASSETS

PREPARED STATEMENT OF LUIS VIGDOR ON BEHALF OF THE INDUSTRY COUNCIL FOR TANGIBLE ASSETS

My name is Luis Vigdor. I am submitting this statement in my capacity as Chairman of the Board of the Industry Council for Tangible Assets. I am a Vice-President of Manfra, Tordella and Brookes, Inc. (MTB). MTB is one of the largest bullion, coin, and foreign exchange trading firms in the United States, with headquarters in New York City and offices throughout the world.

The Industry Council for Tangible Assets (ICTA) is a trade association formed in June 1983 for the purpose of representing the interests of individuals and firms engaged in tangible assets transactions and to educate the public concerning the nature and usefulness of the industry. It is also the purpose of ICTA to accomplish from within the industry the establishment and acceptance of standards and practices designed to ensure the maximum possible protection of consumers from fraud and misappropriation of funds on the part of inexperienced or dishonest firms. Membership in ICTA is open to any individual or firm engaged in the fabrication, manufacture, importation, wholesale distribution, or retail sale of any tangible asset, and also to firms engaged in providing services related to tangible assets. In regard to precious metals ICTA's membership includes some of the largest bullion fabricating and importing firms and also some of the smallest retail coin shops; it also includes many of the major newsletter services that advise and comment upon precious metals investments. ICTA has a Washington office.

We understand that the Subcommittee has convened these hearings to examine the facts concerning the failure in 1983 of two large bullion trading firms and to inquire whether existing federal and state regulatory and enforcement tools provide adequate protection to the consumer from such occurrences.

The members of ICTA share the concern of this Subcommittee, and of the public, that every feasible and useful step be taken to protect consumers and investors from losses attributable to misrepresentations by precious metals dealers and the outright misappropriation of customer funds and assets. However, we do not believe that conclusions regarding increased governmental supervision and control of precious metals transactions should be reached only upon an examination of the events surrounding the failures of International Gold Bullion Exchange and Bullion Reserve of North America. Thus, ICTA wishes to assist the Subcommittee by briefly describing the industry and by identifying the steps being taken within the industry itself to protect against future occurrences of the sort illustrated by the IGBE and Bullion Reserve cases.

The members of ICTA believe that effective self-regulation from within the industry is likely to provide the most efficient, and ultimately the most successful, means of protection for consumers against dealer fraud. We oppose as unnecessary and not in the interests of the public any pervasive plan of regulation of all aspects of the sale of precious metals, whether proposed for state or federal adoption. While it may be possible to address specific aspects of the sale of precious metals to the public in legislation that is narrowly drawn to accomplish specific ends, and which would not deny to dealers and consumers the benefits of free markets in precious metals, we think it premature for the Subcommittee to consider any such legislation at this time. We especially want to call to the Subcommittee's attention the industry's own efforts to develop a program of insurance for precious metals customers or, alternatively, to offer at the customer's election payment and delivery procedures that would provide equivalent protection. We discuss these and other subjects in the following paragraphs.

I. DESCRIPTION OF PRECIOUS METALS INDUSTRY

Gold and silver are the precious metals most commonly held by individuals. Gold could not lawfully be held by U.S. citizens in bullion or bullion coin form in the period 1933-1974. Widespread investor activity in gold in the United States has only developed since 1975. Silver is also widely held in bullion or coin form. In addition both gold and silver have significant industrial and end-product uses which affect the value of the metal itself.

Very little gold is mined in the United States, and its importation in bullion or coin form into the United States, as demand warrants, is generally handled by a few large international mining and trading firms. Silver is both mined in the United States and imported in significant quantities.

The large importing firms sell gold and silver in the United States in bullion and coin form through a network of independent coin and bullion bar retailers who vary greatly in size and volume of business. Some of the large importers also sell at retail.

At the retail level many sales of bullion-type coins are conducted through small dealers who are independent of one another and who only recently have sought to organize effectively on regional and national levels. Some of these small dealers handle sales of gold bullion in bar form as well, but these are fewer in number. Still fewer dealers, and only the largest, directly offer certificate-type arrangements and storage services, but some smaller dealers will offer such arrangements and services through the larger trading firms. Increasingly, banks and major securities brokers are entering into the retail sale of precious metals in bullion or coin form to individual investors, and usually do so through storage arrangements with other firms rather than by selling from an inventory. Securities brokers have access to the American Gold Coin Exchange, an affiliate of the American Stock Exchange, for the execution of transactions for customers in bullion-type coins.

In many cases sales of bullion-type coins occur through dealers who also trade in "numismatic" coins, and in terms of market organization at the retail level there is not always a clear distinction between investment-motivated transactions and collector-motivated transactions. Bullion-type coins are fungible coins the price of which is determined essentially by the current market price of the coin's metal content. Numismatic coins are those whose values reflect not only metal content, but condition, historic significance, and individual aesthetic qualities. In Revenue Ruling 79-143 (1979-1 C.B. 264) the IRS gave tax effect under its "like kind exchange" rules to this essential distinction. More recently the IRS has proposed, in connection with broker reporting requirements, that a mark-up of over 15% of the value of a coin's metal content will distinguish numismatic coins from bullion coins. Proposed Treasury Regulations § 1.6045-1(a)(5); 49 Fed. Reg. 646 (1984). The profit margin on retail transactions in bullion and bullion-type coins is thin and high volume is required for the activity to be commercially feasible. Otherwise transactions are handled by dealers as a service to customers for whom they handle other types of coin transactions.

There is a clear understanding among coin and bullion retailers that transactions in "securities," "futures contracts," and "options" are subject to detailed federal and state regulations. It is equally clear that sales of physical bullion or bullion coins coupled with a fully segregated physical storage service are not subject to these regulatory regimes. Where transactions more complex than cash-for-physical delivery or segregated storage are contemplated, retailers tend to understand the scope of the undertaking and the necessity to conform to extensive regulatory requirements. Thus, generally, a clear demarcation exists in the retail trade that distinguishes regulated transactions from "cash-and-carry" and storage transactions.

The precious metals industry is extremely diverse. It has not been possible to canvass all industry members in preparation for this hearing. We have extensively reviewed the business of retail dealers and certain companies that offer precious metals for individual or bulk segregated storage at independent depositories. Our remarks are directed to these segments of the industry. It should be kept in mind that there are regulated entities and major wholesalers who have developed programs that vary from those followed by the firms we have studied, but which incorporate appropriate protection for the ultimate retail customers. A further study of this additional segment of the industry is a necessary predicate to the adoption of any possible legislation that would affect some or all of the transactions of these firms.

II. AN INDUSTRY VIEW OF THE IGBE AND BULLION RESERVE FAILURES

We assume that the Subcommittee has available to it information from governmental and other sources concerning the IGBE and Bullion Reserve cases. ICTA can offer no information about the details of those specific operations to add to the Subcommittee's knowledge. However, several general points should be noted.

Both IGBE and Bullion Reserve employed massive advertising campaigns in the print and broadcast media to develop sales of gold on a national scale. The result in each case was extraordinary growth in sales achieved over a short period of time. According to published accounts, Alan Saxon commenced his Bullion Reserve activities in 1980, and IGBE commenced operations in 1979. By contrast many bullion and coin dealers who belong to ICTA have been in business for decades.

Published accounts show that IGBE attracted customers by offering gold bullion for sale at prices lower than those available through other retailers, but only on the condition that the customer defer delivery for at least 90 days. The managers of IGBE publicly admitted many months before the firm's collapse that the firm did not always cover itself for deferred delivery on sales until the time for delivery was at hand. (Forbes Magazine, July 19, 1982, p. 42). IGBE apparently placed customers' funds at substantial risk in ventures and investments that fell short of ensuring that subsequent physical delivery to the customers would in all events be assured, a risk about which the customer had no knowledge.

Bullion Reserve at various times also offered gold bullion for sale at prices below those otherwise available and apparently failed to use their customers' funds to buy the gold intended to be purchased by those customers. Instead, Bullion Reserve apparently placed the customers' funds at risk in investment ventures unknown to the customers and unrelated to their simple acquisitive transactions.

It seems clear, even without access to the full facts of these operations, that the managers of IGBE and Bullion Reserve presumed to be able to earn enough profit on investments in futures contracts or other vehicles with the short-term use of customer funds to enable them both to meet their deferred delivery obligations and retain substantial profits themselves. However, such an expectation defies common sense and elemental business experience, which the managers of these firms seemed to have lacked. Ultimately, only a combination of luck and an ever-increasing level of misappropriation of customers' funds can keep such operations going.

While these firms were expanding their sales, and in the end apparently using incoming funds to make good on earlier obligations, many participants in the industry privately expressed skepticism that these firms could both meet their delivery obligations and continue to sell at the low prices so widely advertised. Because precise details of their operations of course were not known, libel laws and the position of many knowledgeable observers as competitors of IGBE and Bullion Reserve impeded the expression of effective public skepticism by those in the industry so disposed.

From the outside, and without all the facts, it appears at the least that IGBE and Bullion Reserve took risks with customer funds of which the customers had no knowledge and which they had not authorized; some reports permit an inference that customer funds were simply stolen. At the same time, however, the context apparently was not that of the "boiler room" operations identified in this Subcommittee's 1982 report on commodity frauds (Sen. Rep. No. 97-495) - which intend only to operate long enough to accumulate and then steal customer funds in amounts sufficient to have justified the operation - but rather involved highly visible and widely advertised efforts that remained afloat for several years. We believe that there are useful lessons to be learned from these events, and that effective countervailing steps can be taken to protect against recurrences, but these do not involve prohibitions against precious metals transactions or pervasive federal or state regulation of precious metals dealers.

III. CURRENT INDUSTRY EFFORTS TO PROTECT AGAINST FURTHER FAILURES AND CUSTOMER LOSSES

The formation of ICTA in part signifies a concerted effort from within the industry to establish a business climate that will afford retail customers of precious metals dealers reasonable protection from fraud and misappropriation of funds. The necessity to do so was recognized by many well before the IGBE and Bullion Reserve problems surfaced. However, the diffusion of activity among competing distributors and among thousands of retailers, each devoting its principal energies to getting started or staying in business, precluded a concerted industry-wide effort. ICTA hopes to fill the gap with maximum efficiency and minimum displacement of dealer independence and freedom of action.

A. Customer Insurance Protection

We are pursuing the development of an industry-wide insurance program through which customers of subscribing dealers would be protected from losses attributable to a dealer's failure by reason of fraud, bankruptcy or insolvency to deliver at the agreed time. The feasibility of such coverage and widespread acceptance of it will turn principally on its cost, part or all of which the consumer will have to bear. We have engaged an experienced insurance broker to present the parameters of our intended program to interested underwriters, and we expect to move forward with this program in the coming months. Insurance offers one avenue for accomplishing satisfactory protection from within the industry, and its ultimate availability may govern the extent to which new and more restrictive laws might be justified as a desirable means of achieving adequate consumer protection.

B. Industry-wide Code of Ethics and Standards

ICTA has undertaken to develop a code of ethics and standards to which its members will subscribe. The development and implementation of such a code presents a number of problems. An unspecific code that requires only general expressions of intent to behave will not address the problems dramatized by the IGBE and Bullion Reserve cases. Also, a code that is not accompanied by a meaningful enforcement mechanism is not likely to be honored by all dealers. However, both specificity of standards and effective enforcement present substantial issues under existing antitrust laws that have to be authoritatively resolved before such a program is put in place. As construed by federal regulatory agencies and the courts, the antitrust laws tolerate substantive industry-wide standards that principally address demonstrable consumer needs and that avoid factors - such as price - that are central to market competition among firms. The antitrust laws also permit enforcement of industry codes that include satisfactory procedural protections for those charged with code violations. ICTA believes that it can develop an effective code consistent with these requirements.

At this point we believe that an ICTA code of ethics and standards could appropriately include the following requirements:

(i) Full disclosure to the customer of all terms and conditions of the sale;

(ii) required identification of the kinds of investor risk inherent in the acquisition;

(iii) segregation of inventory necessary to cover delivery;

(iv) required entry into covering transactions immediately upon receipt of good funds if the order cannot be filled from current inventory;

(v) a time limitation on delivery delays, but with adequate flexibility to account for market conditions;

(vi) the availability of sight draft procedures at the option of the customer;

(vii) storage generally at an independent depository that is subject to regulation as a bank or its equivalent;

(viii) internal accounting for stored items to be maintained by the dealer on a daily basis; and

(ix) periodic outside audits.

The members of ICTA have assigned the highest priority to promulgation of an effective code of ethics and standards. We believe that we are well on the way to completing that task and to working out the many details associated with the basic elements of a code that are listed above. Antitrust considerations impose limits in this area, and we will have to balance the reasonable needs of the public against the right of all dealers to compete in the market place by offering terms of sale and ancillary services of their own design.

C. Advertising Guidelines

As we noted in discussing the IGBE and Bullion Reserve cases, it has been possible to attract customers for precious metals in substantial numbers through advertisements in the print and broadcast media. At the Subcommittee's request we could provide to its staff an analysis of representative examples of these advertisements with specific identification of the questions they raised for informed members of the industry. The advertisements that apparently worked for IGBE and Bullion Reserve at the consumer level generated skepticism on the part of some in the industry. At the time there was no mechanism within the industry through which that skepticism could have generated formal inquiry, and ICTA is seeking to organize a program to perform an appropriate watchdog role in this area.

Media managers have a responsibility to make inquiry when advertising appears that generates reasonable concern whether a responding investor will learn all he should learn about the risk he is undertaking. A trade association could monitor advertisements and suggest to the media the kinds of questions that reasonably could be put to the advertisers concerning the details of the advertised transactions. We believe that the following items constitute a reasonable set of guidelines for the media in this area.

1. Does the seller have or buy the item at the time when the investor transmits good funds?

2. Is the investor allowed to take delivery as soon as his funds clear?

3. Can the source of the dealer's profit be identified - e.g., commission, bid/ask spread or otherwise?

4. Does the seller provide written confirmation of the sale if delivery is delayed for any reason?

5. Do the advertiser's quoted prices include all charges, and is quantity at the advertised price guaranteed?

6. Are the funds or goods belonging to the customers at all times prior to delivery of the items secured from claims of creditors of the dealer?

7. Does the dealer have adequate credit standing with financial institutions?

8. Is the dealer in good standing with ICTA or any other industry-wide association?

Another procedure might first involve trade association factual inquiries, made to the advertiser, following which the association could consult with media managers regarding the extent to which the advertiser was able to establish that its advertisements and follow-up sales efforts fully advised the investors of the risks. The extent to which media managers will cooperate with industry efforts in this area is not clear.

A further possible step could involve countervailing advertising placed in the very media selected by the promoters of questionable programs prepared by an industry association such as ICTA and designed to educate potential investors in how to assess risks inherent in precious metals transactions in general and certain specified arrangements in particular. This approach would involve significant expense at the association level. The Subcommittee should know that some major dealers are presently pursuing this effort on their own and at substantial expense.

D. Education of Public Officials

Notwithstanding adequate legal authority at the state and local levels to investigate, restrain, and prosecute instances of consumer fraud, public officials and prosecutors are often unable to perceive the dangers to the public from certain kinds of promotional activities and possess insufficient knowledge of the precious metals industry and markets. ICTA hopes to be able to address this need by putting together a program of education that would be available to public officials to enable them to scrutinize activity in this area more knowledgeably. Such a program could involve seminars and conferences as well as printed material, training films and tapes, and instructional devices. Of course, ICTA's staff and Board members are already available to consult with public officials at their request on matters of concern to them.

IV. APPROPRIATE GOVERNMENTAL RESPONSES TO SITUATIONS INVOLVING MISREPRESENTATIONS AND FALSE DEALING

The IGBE and Bullion Reserve cases involve especially dramatic and tragic elements. This should not cause one to overlook the stability and demonstrable trustworthiness of the thousands of bullion and coin dealers - large and small - who have through honest effort, and after exposure of their personal capital to substantial risk provided valuable commercial services over the years to millions of investors and collectors. The vast majority of dealers could not compete with IGBE and Bullion Reserve, and the business that went to those firms was denied to these dealers. Moreover, most dealers did not offer deferred delivery programs and did not try to adopt methods that would have met the competitive pressure presented by the activities of these defunct entities.

In our view there is no occasion for drastic restrictions on the freedom of dealers to continue honestly and imaginatively to serve the interests and desires of their customers. We especially want to emphasize that transactions in numismatic items as distinguished from bullion-type items have not been the source of any pattern of fraud and in all events should not be included within the ambit of regulatory changes which the Congress might otherwise consider.

Every industry has its failures, including industries that are pervasively regulated at the state and federal levels. Major banks, securities brokers, and insurance companies, all extensively regulated, are among the kinds of companies whose failures have been widely reported in the past few years, usually at substantial cost to shareholders, suppliers, and customers. Thus governmental oversight plainly is not a guarantee against mistaken business judgments, or fraudulent dealing, that ultimately cause investor losses.

We submit that pervasive state or federal regulation is a last resort remedy. It inevitably increases operating costs and therefore the cost of the product to the consumer. Regulation must imply adequate enforcement resources; otherwise, only responsible members of the industry will comply and the unscrupulous will be free to violate the law. In that situation a real cost advantage attends unlawful activity, which makes the lawless dealer that much more attractive to the public. In the precious metals industry there is a real possibility that extensive regulation of dealers will greatly reduce the number of retail sellers, which is not likely to serve the interests of the public and which will inhibit flexibility in developing efficient responses to consumer needs and preferences.

All states have criminal fraud statutes pursuant to which local and state prosecutors may investigate questionable practices in connection with the sale of tangible assets. Problems of federal preemption which arise in connection with exchange-based commodities transactions and in other areas of financial institution regulation in our view are not present here. Widespread use of interstate advertising and communications media should not be an impediment to prompt and effective investigation by local prosecutors of questionable practices by dealers in precious metals. For example, the locations of the IGBE and Bullion Reserve operations and the identity of their managers were not shrouded in secrecy. As we have noted, complaints from a competitor to a local prosecutor are sometimes met with skepticism, and it may now be the case that suggestions for investigation from a national trade association would have greater effect.

Federal registration and fingerprinting of dealers and salesmen seem to us completely irrelevant to the kind of problem presented by the IGBE and Bullion Reserve cases. We also doubt that a minimum capital requirement would have been relevant in either of those cases, since these firms likely had sufficient access to start-up funds to meet any reasonable capital requirement, and any plausible requirement would have been dwarfed by the amounts of reported investor losses in each case.

The federal securities and commodity exchange laws have provisions that seek to institutionalize self-regulation from within those industries by authorizing the formation of dealer associations that are to possess special code-making and enforcement powers. While the degree of federal agency supervision of such associations under those laws would in our view be inappropriate and unworkable in the precious metals industry, it is possible that the industry would accept and support some form of statutory authority for a trade association that would authorize the association to pursue certain consumer protection activities, including enforcement of a reasonable and flexible code of standards.

We are convinced that regulation of our industry is not required to meet legitimate consumer needs. Through self-regulatory efforts the industry is seeking to provide some form of insurance to cover consumers who buy precious metals for delivery or storage from losses due to dealer failures or fraud. That program will have to be tailored to ensure that excessive costs will not be the result, and we believe this is possible. To allow maximum freedom to dealers, this effort may also include the alternative availability of a sight draft procedure at the election of a customer who might choose not to incur the cost of insurance. Under this latter procedure a customer's funds would not be cleared for transfer to the dealer until a bank or other intermediary received the physical property or satisfactory evidence that the property has been transferred by the dealer and received for the credit of the customer. These efforts, if successful, should eliminate any need for legislation at the state or federal level designed to provide the same or equivalent protection for consumers.

V. THE ULTIMATE PROTECTION: THE EDUCATED INVESTOR

The exercise of restraint and common sense by precious metals investors are the best means for warding off those schemes and situations that present unexpected or undue risk to the investor. The members of ICTA appreciate the value and the necessity of investor education to ensure that investors are able to take care of themselves and that they take no risks not fully identified at the outset of a transaction. Investors should be taught to be cautious about sending funds to distant places in response to aggressive advertising and smooth telephone solicitations from strangers. Of course the great majority of investors exercise adequate care. The keys are to know something about the dealer and to recognize the dangers inherent in delayed delivery.

Institutional advertising aimed at investor education and placed in the same media through which firms such as IGBE and Bullion Reserve achieved so much of their sales should help to heighten the level of investor awareness. There is some evidence that efforts by larger dealers along these lines have had some effect.

Sales of precious metals to investors in bullion or coin form in large volume is a recent phenomenon. Precipitating factors included the repeal in 1974 of the prohibition on ownership of gold by United States citizens, the extreme rate of inflation in the late 70's and the sharp rise in the value of previous metals during 1979-1980. Relative calm has prevailed in the precious metals markets in more recent years, and investors have had an opportunity to learn more about the nature of such investments and the kinds of transactions available to them. These circumstances suggest to us that stringent governmental regulation of gold and silver dealers and transactions should not be necessary to accomplish an appropriate level of investor awareness and capacity for judgment.